

Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales

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INTRODUCTION

In 2005, New York resident Saliha Madden opened a credit card account with Bank of America.¹ Under New York state usury law, a lender is allowed to charge up to 25 percent interest. However, because Bank of America is a national bank, it was able to charge Madden 27 percent interest. Three years later, after having amassed over \$5,000 of debt, Madden stopped making payments to the bank, and the bank sold Madden's debt to Midland Funding, LLC, a debt collector. Midland attempted to collect the 27 percent interest to which Madden originally agreed, but Madden protested and filed suit, claiming that, because Midland was not a national bank, the 27 percent interest rate was usurious under New York state law.

The National Bank Act of 1864² (NBA or “the Act”) allows national banks to charge an interest rate higher than the state's cap on interest under certain circumstances.³ Despite the fact that the Act was passed in 1864, questions about its effect remain unanswered. Notably, the question whether interest rates on national bank–originated debt become usurious when transferred remains unresolved. Historically, Supreme Court opinions have generally favored national banks, as the Court has deemed them “[n]ational favorites.”⁴ However, a recent decision in the Second Circuit calls

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¹ These facts are largely drawn from *Madden v Midland Funding, LLC*, 786 F3d 246, 247–48 (2d Cir 2015).

² 13 Stat 99, codified as amended at 12 USC § 21 et seq. While the Act was not originally named the National Bank Act, Congress has since formally adopted the name. See 12 USC § 38.

³ See 12 USC § 85 (applying the usury law only of the state “where the bank is located” to a national bank regardless of where the national bank conducts business).

⁴ *Tiffany v National Bank of Missouri*, 85 US (18 Wall) 409, 413 (1874).

into question whether deference continues after a national bank has sold its interest in the original loan.⁵

This question is important because it affects the interest rates that consumers will be charged on their loans and could affect how national banks manage their balance sheets.⁶ A restriction on the ability to sell loans may decrease the amount of credit available to consumers, as banks will be forced to retain more risk on their balance sheets.⁷ Yet some contest the impact this may have on lenders, and the general enforcement of usury laws may in fact relieve consumers from heavy interest burdens.⁸ This Comment explores the issue; it concludes that a national bank should be allowed to sell its loans, and that the new owner should be allowed to continue to collect interest that would be usurious if the new owner had originated the loan.

Applying transaction cost economics, this Comment ultimately argues that a court's decision on preemptive effect will not dissuade banks from selling these loans and allowing third-party purchasers to collect at the original interest rate. Of course, preventing a third party from inheriting the preemptive effect of the NBA will make selling loans more costly (that is, it will increase transaction costs) for the bank, but consumers will ultimately have to bear these costs in the form of either higher interest rates or reduced credit. As such, this Comment shows that allowing a third party to inherit preemption not only is supported by an analysis of existing preemption law and the common law but also benefits consumers.

To show that the preemptive force of the NBA should continue upon the sale of a loan to a third party by a national bank, this Comment proceeds in three parts. Part I discusses the history

⁵ See generally *Madden*, 786 F3d 246. See also Part II.B.

⁶ See Brief of the American Bankers Association, Independent Community Bankers of America, California Bankers Association, and Utah Bankers Association as *Amici Curiae* in Support of the Petition for Rehearing and Rehearing En Banc, *Madden v Midland Funding, LLC*, Civil Action No 14-2131, *7–15 (2d Cir filed June 26, 2015) (available on Westlaw at 2015 WL 4153962) (arguing that not allowing a third party to inherit preemption upon a loan sale will cause a “serious disruption of the lending markets”).

⁷ For example, an inability to sell loans made for the purpose of securitizing them into a securitization vehicle may force the bank to hold on to more loans than it usually would. If the bank could sell the loans, it could use the cash generated from such sales to fund new loans; a restriction on the ability to do so may impair the bank's ability to issue credit to consumers and corporations.

⁸ See Brief in Opposition, *Midland Funding, LLC v Madden*, Docket No 15-610, *16–23 (US filed Feb 12, 2016) (available on Westlaw at 2016 WL 552718).

of the NBA; the Supreme Court's jurisprudence on preemption generally, as well as with respect to the NBA; the history and purpose of state usury laws; and the growth in national banks and lending by national banks in the latter part of the twentieth century. Part II discusses the current preemption issue and the differences in interpretation between the Second Circuit and the Fifth and Eighth Circuits. Finally, Part III provides three frameworks—preemption analysis, application of the common law and constitutional law, and a transaction cost framework—to support a conclusion that the preemptive effect of the NBA continues upon the sale of a loan to a third party.

I. PREEMPTION, USURY, AND THE NATIONAL BANK ACT

The National Bank Act has emerged as a powerful tool protecting national banks from state regulation. Originally passed during the Civil War to provide a stable national currency and banking system, the Act provides national banks with a significant shield against intrusion by state regulations and consumer protection laws. This Part proceeds by first considering the origins of the NBA, and second discussing the preemption of state laws, both in general and with respect to the NBA. Finally, this Part concludes with a brief discussion of the history and purpose of state usury laws, followed by an overview of the growth of the consumer protection movement.

A. The National Bank Act

Congress passed the NBA at the height of the Civil War in 1864 to create a stable national currency and banking system during and after the Civil War.⁹ According to one congressman, the Act was supposed to create a national banking system “so perfect” that the state banking system would evaporate, because “the system of State banks [] ha[d] outlived its usefulness.”¹⁰ However, because the NBA was expected to significantly disrupt the state

⁹ See Office of the Comptroller of the Currency, Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed Reg 46119, 46120 (2003) (describing the history of national banking laws, including the NBA).

¹⁰ Cong Globe, 38th Cong, 1st Sess 1256 (Mar 23, 1864) (statement of Rep Hooper). See also *Watters v Wachovia Bank, NA*, 550 US 1, 11 (2007) (claiming that the NBA was intended “[t]o prevent inconsistent or intrusive state regulation from impairing the national [banking] system”).

banking system, Congress worried that states would try to interfere with national banks.¹¹ As such, Congress created the Office of the Comptroller of the Currency (OCC) to exercise oversight, supervisory, and regulatory power over national banks.¹² To be overseen by the OCC (that is, to become a national bank), a bank needs to file its charter with the OCC.¹³

The OCC is responsible for supervising national banks, but it was also established to protect national banks from “hostile state interference.”¹⁴ Congress allocated substantially all responsibility for the national banking system to the OCC, as it believed that a national bank “must not be subjected to any local government, State or municipal; it must be kept absolutely and exclusively under that Government from which it derives its functions.”¹⁵ In some instances, the NBA makes certain areas off-limits to the states. Specifically, the NBA applies only the usury law of the state “where the bank is located” to a national bank, regardless of where the national bank conducts business.¹⁶

Given the regulatory advantages national banks had over state banks after the NBA’s passage, Congress expected the demise of the state banking system.¹⁷ Despite this expectation, most state banks did not convert to national banks immediately after the NBA’s passage.¹⁸ To encourage state banks to convert, Congress enacted a 10 percent tax on notes issued by state banks.¹⁹ Though the purpose of the tax was “scarcely concealed,”²⁰ the Supreme Court upheld the tax, providing another example of Congress’s

¹¹ See *National Banks and the Dual Banking System* *16–17 (Comptroller of the Currency, Sept 2003), archived at <http://perma.cc/FB9U-3HDV>.

¹² See *id.* at *17.

¹³ See 12 USC § 21.

¹⁴ 68 Fed Reg at 46120–21 (cited in note 9).

¹⁵ Cong Globe, 38th Cong, 1st Sess 1893 (Apr 27, 1864) (statement of Sen Sumner).

¹⁶ 12 USC § 85. A bank is located in the state designated in its organization certificate. See *Marquette National Bank of Minneapolis v First of Omaha Service Corp*, 439 US 299, 310 (1978) (observing that congressional delegates assumed during debate over the NBA that a national bank would be “‘located’ for purposes of [12 USC § 85] in the [s]tate named in its organization certificate”). The NBA requires persons forming a national bank to list “[t]he place where its operations of discount and deposit are to be carried on, designating the State, Territory, or District, and the particular county and city, town, or village” in the organization certificate. 12 USC § 22.

¹⁷ *National Banks and the Dual Banking System* at *16 (cited in note 11).

¹⁸ See *id.* at *18 (noting that “state banks failed to convert in expected numbers”).

¹⁹ See Richard Scott Carnell, Jonathan R. Macey, and Geoffrey P. Miller, *The Law of Banking and Financial Institutions* 9 (Aspen 4th ed 2009) (“Congress provided the stick in 1865 by imposing a punitive and constitutionally suspect 10% tax on state bank notes.”).

²⁰ *Veazie Bank v Fenno*, 75 US (8 Wall) 533, 556 (1869) (Nelson dissenting).

power regarding national banking.²¹ Going further, the Supreme Court has since said that national banks were “designed to be used to aid the government in the administration of an important branch of the public service. . . . [T]he States can exercise no control over them, nor in any wise affect their operation, except in so far as Congress may see proper to permit.”²² The Supreme Court, dating back to *McCulloch v Maryland*,²³ has “held federal law supreme over state law with respect to national banking.”²⁴ As a result, state laws are often considered preempted by the NBA.²⁵ A proper understanding of this special standard, however, also requires considering the origins of national preemption laws.

B. National Preemption of State Laws

The Supremacy Clause of the Constitution establishes that national laws supersede state laws, and federal preemption doctrine emanates from the Supremacy Clause.²⁶ The Supremacy Clause resolves the foreseeable conflict that can occur when two governments (national and state) are permitted to legislate on an issue, and it “provides a clear rule that federal law ‘shall be the supreme Law of the Land.’”²⁷ Courts have established the doctrine of preemption to implement the clear rule of the Supremacy Clause. Preemption claims are evaluated based on three theories of preemption: express preemption, field preemption, and conflict preemption. Express preemption is found when Congress has “withdraw[n] specified powers from the States by enacting a statute containing an express preemption provision.”²⁸ Field preemption has generally been found when “Congress has legislated so comprehensively that federal law occupies an entire field of regulation and leaves no room for state law.”²⁹ Lastly, conflict preemption is found “when compliance with both state and federal law is

²¹ See id at 549.

²² *Farmers' and Mechanics' National Bank v Dearing*, 91 US 29, 33–34 (1875).

²³ 17 US (4 Wheat) 316 (1819).

²⁴ *Watters*, 550 US at 10.

²⁵ See id at 12 (“[W]hen state prescriptions significantly impair the exercise of authority, enumerated or incidental under the NBA, the State’s regulations must give way.”).

²⁶ See US Const Art VI, cl 2.

²⁷ *Arizona v United States*, 132 S Ct 2492, 2500 (2012), quoting US Const Art VI, cl 2.

²⁸ *Arizona*, 132 S Ct at 2500–01. See also *Chamber of Commerce of the United States v Whiting*, 131 S Ct 1968, 1977 (2011) (“When a federal law contains an express preemption clause, we focus on the plain wording of the clause.”) (quotation marks omitted).

²⁹ *Wachovia Bank, NA v Burke*, 414 F3d 305, 313 (2d Cir 2005).

impossible, or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”³⁰

Despite a robust preemption doctrine, the Court has generally adopted a presumption against preemption.³¹ To rebut this presumption, the Court looks to congressional intent, calling it “‘the ultimate touchstone’ in every pre-emption case.”³² As discussed above, Congress’s intent in passing the NBA was to relieve future national banks from state interference.³³ As a result, the presumption against preemption is generally inapplicable in NBA cases.³⁴

Shortly after the NBA’s passage, the Supreme Court began establishing preemption standards for the NBA. In *Tiffany v National Bank of Missouri*,³⁵ the Court addressed the question whether a national bank could charge a higher rate of interest than a state’s usury law permitted because it was located in another state.³⁶ The Court upheld § 30 of the NBA (now 12 USC § 85), allowing a national bank to charge a higher rate of interest.³⁷ The Court additionally declared that national banks were “[n]ational favorites” and were expected to “tak[e] the place of [s]tate banks.”³⁸ While express preemption was at work in *Tiffany*, courts most often apply conflict preemption doctrine when determining whether the NBA preempts applicable state laws.³⁹

³⁰ *California v ARC America Corp.*, 490 US 93, 100–01 (1989) (quotation marks and citation omitted).

³¹ See *Wyeth v Levine*, 555 US 555, 565 (2009); *Barnett Bank of Marion County, NA v Nelson*, 517 US 25, 30 (1996) (“This question is basically one of congressional intent. Did Congress, in enacting the Federal Statute, intend to exercise its constitutionally delegated authority to set aside the laws of a State? If so, the Supremacy Clause requires courts to follow federal, not state, law.”).

³² *Medtronic, Inc v Lohr*, 518 US 470, 485 (1996), quoting *Retail Clerks International Association, Local 1625, AFL–CIO v Schermerhorn*, 375 US 96, 103 (1963).

³³ See Part I.A.

³⁴ See note 25 and accompanying text.

³⁵ 85 US (18 Wall) 409 (1874).

³⁶ *Id.* at 410–11.

³⁷ *Id.* at 413.

³⁸ *Id.*

³⁹ See *Watters*, 550 US at 11, citing *Davis v Elmira Savings Bank*, 161 US 275, 290 (1896) (“Federally chartered banks are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA.”).

C. The NBA and Preemption of State Laws

1. *Marquette* and the rise of national banks.

In the modern era, the Supreme Court has generally held, in line with *Tiffany*, that the NBA preempts state law. However, recent cases show that the preemption of state law is not a *fait accompli* upon the invocation of the NBA. *Marquette National Bank of Minneapolis v First of Omaha Service Corp*⁴⁰ sets the stage. In *Marquette*, the Court addressed whether 12 USC § 85 allowed a national bank organized in one state to charge interest at a rate acceptable in the state where it was located to out-of-state customers.⁴¹ A unanimous Court declared that 12 USC § 85 “ha[d] been interpreted for over a century to give ‘advantages to National banks over their State competitors.’”⁴² The Court determined that the interest rate on interstate loans was “governed by federal law” and that “a national bank may charge interest on any loan at the rate allowed by the laws of the State in which the bank is located.”⁴³ Despite the lack of relevant legislative history, the Court concluded that Congress was aware of a well-functioning interbank loan-trading-and-endorsing system when it enacted the NBA.⁴⁴ As a result, the Court did not find Congress’s silence to be dispositive; rather, the Court held that the NBA did not exclude interstate loans.⁴⁵

The Court’s decision in *Marquette* allowed national banks to export one state’s usury laws into all other states. Additionally,

⁴⁰ 439 US 299 (1978).

⁴¹ *Id.* at 301.

⁴² *Id.* at 314, quoting *Tiffany*, 85 US (18 Wall) at 413.

⁴³ *Marquette*, 439 US at 308 (quotation marks omitted).

⁴⁴ Citing precedent, the Court in *Marquette* noted that “numerous judicial decisions in cases arising out of interstate loan transactions” support the proposition that Congress was aware of the market for interstate loans. *Id.* at 317. The interbank loan-trading-and-endorsing system allows banks to diversify their risk away from local populations and provides an additional supply of financing capital to areas where local banks cannot meet the needs of local borrowers. In defining the interbank loan-trading-and-endorsing system, the Court noted that “[m]oney is frequently borrowed in one state, by a corporation created in another. The numerous banks established by different states are in the constant habit of contracting and dealing with one another.” *Id.*, quoting *Bank of Augusta v Earle*, 38 US (13 Pet) 519, 590 (1839). Additionally, the Court cited several scholarly works as historical evidence of the existence of an active interbank loan-trading-and-endorsing system when the NBA was passed. *Marquette*, 439 US at 317. For one of the scholarly works cited by the Court, see R.M. Breckenridge, *Discount Rates in the United States*, 13 *Polit Sci Q* 119, 136–38 (1898) (discussing how banks augment local capital supplies by using an interbank system).

⁴⁵ *Marquette*, 439 US at 318.

the Court rejected the argument that a national bank was located in the state in which the loan was made. Such a decision could “throw into confusion the complex system of modern interstate banking,” and the Court relied on administrability concerns to reject this argument.⁴⁶

The Supreme Court’s jurisprudence with respect to the NBA, especially its decision in *Marquette*, led to a dramatic rise in the size and scale of national banks. Contrary to Congress’s expectations, nationally chartered banks did not initially overshadow their state-chartered peers.⁴⁷ However, over time national banks have come to dominate the market, especially after *Marquette*. The ease of chartering a national bank,⁴⁸ coupled with the general rule that the NBA preempts state consumer protection laws, led to significant growth in the amount of assets held by national banks during the latter part of the twentieth century.⁴⁹ Due to consolidation and other factors, the proportion of assets held by nationally chartered banks increased from 56.3 percent to 69.4 percent of all assets held by banks from 1997 to 2009.⁵⁰ Perhaps unsurprisingly, these banks have tended to be located in Delaware and South Dakota because of these states’ lax (indeed, almost nonexistent) usury laws.⁵¹

2. Preemption doctrine after *Marquette*.

Marquette sheds light on the Court’s preemption jurisprudence with respect to the NBA. Because congressional intent is the guiding light of preemption analysis, the Court’s focus on Congress’s knowledge during the passage of the NBA was paramount

⁴⁶ Id at 312–13.

⁴⁷ See text accompanying notes 17–18.

⁴⁸ See 12 USC § 21. Chartering a national bank is relatively straightforward. Though a de novo application for a national bank charter will require approval from the OCC (and potentially the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve), regulators will look only to the bank’s business plan, management experience, and financial resources. See *Becoming a National Bank* *1–3 (OCC, Feb 2011), archived at <http://perma.cc/6H8B-CBRM>. While it takes planning and know-how to start a national bank, there is nothing about receiving a national bank charter that makes it prohibitively difficult compared to the state-chartering process.

⁴⁹ See Gary W. Whalen, *Why Do De Novo Banks Choose a National Charter?* *1–2 (OCC Economics Working Paper No 2010-2, May 2010), archived at <http://perma.cc/K2F7-ZSJK> (showing that from 1998 to 2008 the percentage of assets held by national banks increased).

⁵⁰ Id at *1 n 2.

⁵¹ See Robin Stein, *The Ascendancy of the Credit Card Industry* (Frontline, Nov 23, 2004), archived at <http://perma.cc/C256-EV6C>. Both Delaware and South Dakota effectively have no usury laws. See note 259.

to its determination that the ambiguity within the statute should be resolved in favor of national banks.

The Court provided more-fulsome guidance on NBA preemption analysis in *Barnett Bank of Marion County, NA v Nelson*,⁵² in which the Court held that the NBA preempted a Florida law restricting national banks from selling insurance.⁵³ Florida had passed a law that restricted national banks' ability to sell insurance in Florida despite the fact that federal law permitted national banks to sell insurance.⁵⁴ The Court concluded that neither explicit nor field preemption was applicable, and it therefore employed conflict preemption.⁵⁵ Because federal law did not mandate that national banks sell insurance but only authorized them to do so, Florida's restrictions did not expressly conflict with the NBA. However, the state law conflicted with the purpose of the statute unless the "federal purpose [was] to grant the bank only . . . permission to sell insurance to the extent that state law also grant[ed] permission to do so."⁵⁶

The Court sidestepped this argument, finding that, by giving a national bank permission to sell insurance, Congress was giving national banks an additional power.⁵⁷ The provision of an additional power by Congress is important because the Court has traditionally interpreted a grant of power to national banks as preempting contrary state law.⁵⁸ When Congress grants a power to a national bank, the Court assumes that Congress does not want state laws to impair either the functioning of national banks or the exercise of their powers.⁵⁹ Noting that this presumption of preemption may limit a state's ability to regulate a national bank, the Court stated that state laws are not preempted to the extent that state laws "do[] not prevent or *significantly interfere* with the national bank's exercise of its powers."⁶⁰

⁵² 517 US 25 (1996).

⁵³ *Id.* at 28.

⁵⁴ *Id.* at 28–29.

⁵⁵ *Id.* at 31.

⁵⁶ *Barnett Bank*, 517 US at 31 (emphasis omitted).

⁵⁷ See *id.* at 32.

⁵⁸ *Id.* (noting that the "history [of bank legislation] is one of interpreting grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law").

⁵⁹ *Id.* at 33–34.

⁶⁰ *Barnett Bank*, 517 US at 33 (emphasis added). See also *National Bank v Commonwealth*, 76 US (9 Wall) 353, 362 (1869) ("[A]gencies of the Federal government [like national banks] are only exempted from State legislation, so far as that legislation may interfere with,

Barnett Bank lays out the standard preemption analysis that the Court typically performs when presented with a conflict between state law and the NBA. To determine if the NBA preempts state law, the Court will first ask if the state and federal statutes are “in irreconcilable conflict” with one another.⁶¹ The most obvious form of irreconcilable conflict involves not just grants of power but affirmative mandates requiring the exercise of the granted power. For example, in *Barnett Bank*, this type of conflict would have existed if the NBA had mandated national banks to sell insurance while state law simultaneously forbade them from doing so. Even if this form of irreconcilable conflict is not found, the Court presumes “that normally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted.”⁶² In *Barnett Bank*, the answer to this question was relatively simple: a state law prohibition of a national bank’s power significantly impairs the bank’s ability to exercise that power. Since the Court found that allowing national banks to sell insurance gave them the power to do so, the state law prohibition significantly impaired national banks’ ability to exercise their power.⁶³ However, in other cases, the question whether a state regulation would significantly impair the power of a national bank turns on an intensely fact-based inquiry.

While national banks were protected from state interference after *Barnett Bank*, an open question remained: Do national bank subsidiaries receive the same protection? The Supreme Court answered affirmatively in *Watters v Wachovia Bank, NA*.⁶⁴ The Court focused not on legal entity structure but on the powers of the national bank, similar to the Court’s focus in *Barnett Bank*. Wachovia acquired a mortgage lender in Michigan that had been subject to Michigan’s financial regulation.⁶⁵ Upon acquisition, Wachovia informed Michigan’s financial regulator that it would no longer be submitting to state supervisory control because the subsidiary was now entitled to preemption against state regulatory authority.⁶⁶ In determining that Michigan could no longer regulate the subsidiary, the Court reiterated that “federal control

or impair their efficiency in performing the functions by which they are designed to serve that government.”).

⁶¹ *Barnett Bank*, 517 US at 31 (quotation marks omitted).

⁶² *Id.* at 33.

⁶³ See *id.* at 34–35.

⁶⁴ 550 US 1 (2007).

⁶⁵ *Id.* at 8.

⁶⁶ *Id.* at 8–9.

shields national banking from unduly burdensome and duplicative state regulation.”⁶⁷ The Court concluded that national banks and their subsidiaries are allowed to “engage[] in the business of banking.”⁶⁸ As such, the subsidiary had the power to engage in mortgage lending, as ongoing regulation at the state level would “hamper[] the federally permitted activities of a national bank.”⁶⁹ The Court’s focus in the preemption analysis was “on the exercise of a national bank’s powers, not on its corporate structure.”⁷⁰ Put another way, when a subsidiary is using a power Congress granted to national banks, preemption analysis continues as if the national bank itself were engaging in the activity. The same is not true of other powers. Thus, a national bank subsidiary that is engaged in selling computers would be subject to state regulation, because the sale of merchandise is not a power of national banks.⁷¹

The Court’s highly deferential posture when it comes to national banks stems from both Congress’s intent in passing the NBA and the idea that certain acts of Congress bestow powers on national banks that grant banks the presumption of preemption unless state laws do not significantly interfere with those powers. The Court’s deferential posture is not, however, without limits. In *Cuomo v Clearing House Association, LLC*,⁷² the Court determined that the OCC’s regulations had gone too far. Regulations issued by the OCC established that it was the only entity that could exercise visitorial powers⁷³ over a national bank, even in cases of “[e]nforcing compliance with any applicable federal or state laws.”⁷⁴ Applying *Chevron* deference,⁷⁵ the Court determined

⁶⁷ Id at 11.

⁶⁸ *Watters*, 550 US at 21 (quotation marks omitted). See also 12 USC § 371(a) (allowing a national bank to issue mortgages). The general powers of national banks are spelled out in 12 USC § 24, and 12 USC § 24a provides authorization for a national bank’s subsidiaries to engage in banking activities.

⁶⁹ *Watters*, 550 US at 18, 21.

⁷⁰ Id at 18 (emphasis omitted).

⁷¹ See id at 21 (“The NBA is thus properly read by OCC to protect from state hindrance a national bank’s engagement in the ‘business of banking’ whether conducted by the bank itself or by an operating subsidiary, empowered to do *only* what the bank itself could do.”) (emphasis added).

⁷² 557 US 519 (2009).

⁷³ “Visitorial powers” generally “refers to a sovereign’s supervisory powers over corporations,” including “any form of administrative oversight that allows a sovereign to inspect books and records on demand.” Id at 535.

⁷⁴ Id at 524–25, quoting 12 CFR § 7.4000.

⁷⁵ See generally *Chevron U.S.A. Inc v Natural Resources Defense Council, Inc*, 467 US 837 (1984).

that the OCC's interpretation of the term "visitorial powers" was not reasonable given the historical context of the term.⁷⁶

Despite *Clearing House Association*, the Court's jurisprudence on NBA preemption is still highly deferential and suspicious of state interference with the powers of national banks. That stance remains unchanged by the financial crisis and the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁷⁷ Dodd-Frank did, however, amend the NBA by codifying a preemption standard in 12 USC § 25b.⁷⁸ 12 USC § 25b adopts the "significantly interferes" language of *Barnett Bank* after specifically citing that case as the applicable preemption standard.⁷⁹ Further, the OCC may make preemption determinations on a case-by-case basis, but those determinations will still be subject to the *Barnett Bank* standard and traditional *Chevron* deference to the OCC's interpretation of the NBA's language.⁸⁰ The codification of the *Barnett Bank* standard by Congress suggests that the associated powers were granted to national banks and that the OCC's interpretation of those powers will continue to have significant force in preempting state laws.

The suspicion of state interference underlying the NBA did not extend to state usury laws. While the NBA restricted states from interfering with national banks, the states remained the source of interest rate limits.⁸¹ Therefore, the preemption of state usury laws can be fully understood only in the context of the history and purpose of usury laws.

D. The History and Purpose of Usury Laws

Usury laws have existed for most of recorded history.⁸² While usury laws emerged as a result of moral disapprobation of lending in general and lending at excessive interest rates in particular,⁸³

⁷⁶ See *Clearing House Association*, 557 US at 525–31.

⁷⁷ Pub L 111-203, 124 Stat 1376 (2010), codified at 12 USC § 5301 et seq.

⁷⁸ 124 Stat at 2014–17.

⁷⁹ 12 USC § 25b(b)(1) (stating that "[s]tate consumer finance laws are preempted" "in accordance with the legal standard . . . in *Barnett Bank of Marion County*").

⁸⁰ See 12 USC § 25b(b).

⁸¹ See 12 USC § 85.

⁸² See Amanda Katherine Sadie Hill, Note, *State Usury Laws: Are They Effective in a Post-GLBA World?*, 6 NC Bank Inst 411, 421 (2002) ("As examples from Aristotle to the Bible illustrate, usury laws have been enacted throughout most of recorded history.") (quotation marks omitted).

⁸³ See James M. Ackerman, *Interest Rates and the Law: A History of Usury*, 1981 Ariz St L J 61, 63–65 (describing how early civilizations adopted usury laws primarily due to moral rather than economic considerations).

they persist today to protect consumers. Without usury laws, consumer advocates believe consumers would be unprotected from disingenuous lenders.⁸⁴ Advocates claim the average consumer does not have enough knowledge to fully understand the implications of most loans, especially the most pernicious lending practices such as payday lending and instant tax refunds.⁸⁵ Further, advocates argue that extremely high interest rates can lead to a cycle of borrowing that unsophisticated consumers cannot understand when they initially take out a loan and cannot escape once they do.⁸⁶ To protect these consumers, states limit the amount of interest lenders can charge via usury laws.

While these consumer protection arguments reflect what courts and academics typically acknowledge as the purpose of usury laws, some commentators have suggested that usury laws may also constrain or deter potentially risky behavior that results from the creation and continuation of the welfare state.⁸⁷ Additionally, behavioral economics research continues to find that consumers may have time-inconsistent discount rates. That is, consumers value benefits received over time (such as dividends or annuity payments) in a way that is inconsistent, such that increases in value across the same period of time will be thought of differently depending on how much time has already passed. Such inconsistency is not the expected result under the traditional rational expectations approach to discounting.⁸⁸ The presence of

⁸⁴ See Hill, Note, 6 NC Bank Inst at 422 (cited in note 82) (“The hope is that consumers who are not financially well informed will not fall victim to unfair lending practices.”).

⁸⁵ See *id.* at 421–22 (claiming that consumers misunderstand or undercomprehend information about these loans, such that they appear to consumers to be cheaper than they truly are).

⁸⁶ See Robert Mayer, *Loan Sharks, Interest-Rate Caps, and Deregulation*, 69 Wash & Lee L Rev 807, 837–39 (2012) (showing that high interest rates lead to longer duration loans, constituting a “debt trap[]”).

⁸⁷ See Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J Legal Stud 283, 285 (1995) (arguing that “[t]he provision of welfare . . . produces perverse incentives to take credit risks . . . [and] restrictive contract doctrines are appropriate means for deterring this socially costly behavior”).

⁸⁸ For example, when offered a choice between \$50 today and \$100 one year from now, most people will choose \$50 today. However, when offered the choice between \$50 in five years and \$100 in six years, most people will choose \$100 in six years. The difference in value between both options should be the same from a temporal perspective—there is a one-year delay in either case—so people’s choices reflect time-inconsistent discounting. See Leonard Green, Astrid F. Fry, and Joel Myerson, *Discounting of Delayed Rewards: A Life-Span Comparison*, 5 Psychological Sci 33, 33–34 (1994). See also generally Shane Frederick, George Loewenstein, and Ted O’Donoghue, *Time Discounting and Time Preference: A Critical Review*, 40 J Econ Lit 351 (2002).

time-inconsistent discount rates may favor a paternalistic response in the form of usury laws.

Like any price cap, usury laws may also have deleterious rationing effects. For instance, potential borrowers whose risks warrant interest rates higher than the maximum rate set by usury laws may not be able to borrow money. Economic intuition makes clear that price restrictions reduce the quantity of goods supplied,⁸⁹ and empirical evidence supports this on a microeconomic level: if the rate of allowable interest increases, more loans will be made.⁹⁰ While this critique is attractive, it does not address the normative issue: Should governments enforce an artificial limit on interest rates to protect consumers? The classic libertarian response assumes that freedom of contract is supreme,⁹¹ and some commentators have gone so far as to suggest that the enforcement of closely related doctrines like unconscionability (and perhaps their very existence) harms consumers by “encourag[ing] irresponsibility and hence greater dependency” on the laws.⁹²

Regardless of the market limitations and potential normative arguments against usury laws, they continue to exist, in some form, in all fifty states.⁹³ While the NBA could have suspended all usury laws, Congress instead chose to adopt the state usury laws for its own purposes within the NBA.⁹⁴ Of course, Congress did intend for the NBA to create uniformity,⁹⁵ which cuts against the idea that Congress did not intend for the NBA to preempt state usury laws. Perhaps more persuasively, when Congress allowed banks to have interstate branches,⁹⁶ Congress adopted a usury savings clause that, in no uncertain terms, reiterated that 12 USC

⁸⁹ See, for example, William J. Baumol and Alan S. Blinder, *Microeconomics: Principles and Policy* 375–76 (Cengage Learning 13th ed 2015).

⁹⁰ See Oren Rigbi, *The Effects of Usury Laws: Evidence from the Online Loan Market*, 95 *Rev Econ & Stat* 1238, 1239–47 (2013) (showing that “[b]orrowers who were restricted under their original [usury] cap benefited from the increase in the cap, and the marginal borrower benefited most”).

⁹¹ See Jeremy Bentham, *Defence of Usury: Shewing the Impolicy of the Present Legal Restraints on the Terms of Pecuniary Bargains* 2 (printed for T. Payne 2d ed 1790).

⁹² Horacio Spector, *A Contractarian Approach to Unconscionability*, 81 *Chi Kent L Rev* 95, 116 (2006).

⁹³ Even Delaware and South Dakota, the states where most national banks are located, have usury laws, albeit weak ones. See note 259.

⁹⁴ See 12 USC § 85.

⁹⁵ See notes 9–11 and accompanying text.

⁹⁶ See Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub L No 103-328, 108 Stat 2338.

§ 85 would continue to have preemptive effect.⁹⁷ However, courts remain split as to which usury law Congress intended to apply when a national bank–originated loan is transferred.

E. The Rise of the Consumer Protection Movement

The growing preeminence of national banks, coupled with their ability to avoid most state law consumer protection regulation because of preemption, has spurred increasingly vocal advocacy for consumer protection in the context of financial products. These advocates point to a growing body of empirical literature to illustrate the harms associated with an underregulated financial industry. This Comment straddles the border of this ongoing debate between advocates and critics—a debate that has not focused on usury, despite usury’s relationship to consumer finance, largely because the decision in *Marquette* allows national banks to import the lax usury laws of Delaware and South Dakota to the rest of the country.

A growing body of literature suggests that the growth of national banks has led to a growth in the availability of financing, which has caused consumer distress. These critiques focus on the growth of fees and short-term credit products with interest rates above 100 percent.⁹⁸ While the criticisms of the banking system are varied, one argument is that preemption allows national banks to skirt state consumer protection laws. To consumer financial protection advocates, the prevalence of preemption within banking law has resulted in a situation in which “almost any state statute designed to protect consumers is preempted by federal law.”⁹⁹ This critique does not rely on the assumption that state

⁹⁷ Specifically, Congress reiterated its stance on the preemptive force of 12 USC § 85 when it passed the Riegle-Neal Act and allowed for interstate branches. In a portion of the Act codified in a note accompanying 12 USC § 1811, Congress stated that “[n]o provision of this title and no amendment made by this title to any other provision of law shall be construed as affecting in any way . . . the applicability of [12 USC § 85].” Riegle-Neal Act § 111, 108 Stat at 2365.

⁹⁸ See Oren Bar-Gill and Elizabeth Warren, *Making Credit Safer*, 157 U Pa L Rev 1, 44–46 (2008); Ronald J. Mann and Jim Hawkins, *Just until Payday*, 54 UCLA L Rev 855, 857–61, 871–72 (2007) (describing short-term credit products with annual interest rates over 400 percent and suggesting that 12 USC § 85 may have been one of the contributing factors allowing these products to flourish); Michael S. Barr, *Banking the Poor*, 21 Yale J Reg 121, 154–62 (2004) (describing the difficulties consumers face if they lack access to traditional banking products).

⁹⁹ Bar-Gill and Warren, 157 U Pa L Rev at 83 (cited in note 98), citing Mark Furletti, Comment, *The Debate over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards*, 77 Temple L Rev 425, 426 (2004).

regulation is inherently good—advocates admit that “[i]n an era of interstate banking, uniform regulation of consumer credit products at the federal level may well be more efficient than a litany of consumer protection rules that vary from state to state.”¹⁰⁰ Rather, these advocates cite the failure of federal regulatory agencies to provide adequate protection to consumers.¹⁰¹

Critics of the consumer protection movement reply to these concerns from many angles. Some posit that consumer financial “injuries” are not, in fact, injuries—injuries result in deadweight losses while, in consumer financial products, the harm to the consumer is a gain to the creditor, meaning that there is no deadweight loss.¹⁰² In areas such as tort law, in which harms produce deadweight losses, ex ante regulation is appropriate—but consumer financial products do not have the same attributes.¹⁰³ Ex ante regulation will not result in increased efficient precautions but rather in reduced supply of the product, which may impact the most vulnerable consumers.¹⁰⁴ Additionally, other critics respond to the preemption point by showing that curtailing preemption would reduce the availability of credit and, thus, would be inefficient.¹⁰⁵ This debate persists even after the creation of the Consumer Financial Protection Bureau (CFPB), an independent agency created by Dodd-Frank that has been supported by advocates of consumer financial protection since before its inception.¹⁰⁶ The legal question—whether preemption of state usury laws continues upon the sale of a loan to a non-national bank third party—implicates this debate in some sense, but courts, rather than Congress, will be the arena in which it is answered.

¹⁰⁰ Bar-Gill and Warren, 157 U Pa L Rev at 83 (cited in note 98).

¹⁰¹ See id at 70–77 (highlighting the failures of the current national regulatory system).

¹⁰² See Robert M. Lawless, *The Limits of Contract as Product*, 157 U Pa L Rev PENNumbra 160, 163–64 (2009).

¹⁰³ See id.

¹⁰⁴ See id.

¹⁰⁵ See Joseph R. Mason, Robert Kulick, and Hal J. Singer, *The Economic Impact of Eliminating Preemption of State Consumer Protection Laws*, 12 U Pa J Bus L 781, 792–800 (2010).

¹⁰⁶ See Bar-Gill and Warren, 157 U Pa L Rev at 98–100 (cited in note 98) (proposing the creation of “a single federal regulator . . . that w[ould] be put in charge of consumer credit products”).

II. THE LAW OF THIRD-PARTY TRANSFERS OF NONUSURIOUS LOANS

When making and processing loans, national banks are effectively immune from state laws via preemption.¹⁰⁷ However, when a national bank sells a loan, it remains an open question whether the NBA's preemptive effect continues. Effectively, given the preemptive force of 12 USC § 85, a Delaware-based national bank can make a loan to a New York resident at a rate of interest that would be usurious under New York law but not usurious under Delaware law. However, if the national bank sells the loan, can the third-party non-national bank buyer collect at an interest rate that is usurious under New York law—that is, does the preemptive power of the NBA continue upon the sale of the loan to a third party?

The Supreme Court has never decided this issue, but several circuits have reached diverging opinions. Specifically, the Fifth and Eighth Circuits have held that a nonusurious loan cannot be made usurious upon sale, while the Second Circuit has concluded that once a national bank is no longer affiliated with the loan, the loan may be made usurious.¹⁰⁸ This Part examines the decisions of the Fifth and Eighth Circuits and shows that they lend support for continuing preemption after a loan transfer by adoption of the “once nonusurious, always nonusurious” doctrine. The Seventh Circuit, in a case unrelated to NBA preemption, also adopted the once nonusurious, always nonusurious policy, and the Seventh Circuit's analysis is discussed and applied to the preemption issue in this Part. Next, this Part discusses the Second Circuit's opinions on NBA preemption, culminating in *Madden v Midland Funding, LLC*,¹⁰⁹ in which the court held that preemption does not carry forward posttransfer.¹¹⁰ Finally, it compares the different analyses conducted by the Fifth, Eighth, and Second Circuits and puts to rest any possibility for distinguishing the cases on the facts.

A. Initial Holdings Support Preemption Continuing Postsale

Neither the Fifth nor the Eighth Circuit has explicitly ruled on the question of NBA preemption in the context of third-party

¹⁰⁷ See Part I.C.

¹⁰⁸ See Parts II.A–B.

¹⁰⁹ 786 F3d 246 (2d Cir 2015).

¹¹⁰ *Id.* at 250.

transfers. However, cases within these circuits suggest that they hold the view that, once a nonusurious loan has been originated, the loan remains nonusurious for the remainder of its life, regardless of whether the loan is transferred. The Fifth Circuit addressed a related transfer issue in *Federal Deposit Insurance Corp v Lattimore Land Corp*.¹¹¹ Lattimore had taken out a note from the Hamilton Mortgage Corporation.¹¹² Hamilton Mortgage Corporation was a Georgia-based financial company (not a national bank), which charged Lattimore an interest rate that was allowable under Georgia law.¹¹³ Hamilton fell into distress and transferred over 90 percent of the interest in the loan to a related entity—the Hamilton National Bank, a Tennessee-based national bank.¹¹⁴ The FDIC eventually put Hamilton National Bank into receivership and attempted to collect on the debt Lattimore owed Hamilton National Bank.¹¹⁵

Lattimore claimed Hamilton National Bank could not collect on the loan because the loan was usurious under Tennessee law, which Lattimore alleged applied to Hamilton National Bank per the NBA.¹¹⁶ The court found that the NBA did not apply and that normal choice-of-law rules suggested that the law of the state where the loan originated would control whether usury was an applicable defense to nonpayment of the loan.¹¹⁷ Summarizing its holding, the court stated that “the note, initially non-usurious, remains so.”¹¹⁸

The Eighth Circuit furthered this logic in *Krispin v The May Department Stores Co*.¹¹⁹ May Department Stores created an Arizona-based national bank to operate its credit card division. The national bank would assign the receivables from the origination of credit to May Department Stores. Cardholders brought suit against May Department Stores alleging a usurious interest rate because the rate charged was above the rate allowed

¹¹¹ 656 F2d 139 (5th Cir 1981).

¹¹² *Id* at 140.

¹¹³ See *id* at 146–47, 148 n 16.

¹¹⁴ *Id* at 146.

¹¹⁵ *Lattimore*, 656 F2d at 141.

¹¹⁶ *Id* at 146.

¹¹⁷ *Id* at 148–50. See also *id* at 149 n 18 (declining to reach but expressing skepticism about the defendants’ argument that “under 12 USC § 85, the Hamilton National Bank being located in Tennessee may only have held notes bearing 10% interest” because this argument “cut[] against the rule of validation generally applicable to allegedly usurious contracts with a substantial relation with more than one state”).

¹¹⁸ *Id* at 148.

¹¹⁹ 218 F3d 919 (8th Cir 2000).

in Missouri, where May Department Stores was located.¹²⁰ May Department Stores asserted a preemption defense because the originator of the credit was the national bank, not May Department Stores.¹²¹ The interest rate charged was not usurious under Arizona law and, as such, May Department Stores believed the claim failed.

Focusing on *Lattimore* as persuasive precedent, the Eighth Circuit looked to the originator of the debt to determine if the loan was usurious.¹²² Because a national bank originated the loan, the Eighth Circuit held that the NBA applied and preempted Missouri state law usury claims.¹²³ Even though May Department Stores purchased the loans from the national bank, the court determined that it was more appropriate to look to the originating entity than to the assignee.¹²⁴ The bank's origination of the loans and ongoing involvement in the servicing of the loans was determinative of the issue such that the court did not conduct a thorough conflict preemption analysis; instead, it asserted that complete preemption allowed the national bank to avoid the state law usury claims.¹²⁵ However, the court did not rule on the other purely state law claims brought by the plaintiffs, including "breach of contract, breach of duty of good faith and fair dealing, misrepresentation, unjust enrichment, and civil conspiracy."¹²⁶ Thus, while the NBA may preempt usury claims, state law claims unpreempted by the NBA survive, and a national bank is likely subject to these types of claims.¹²⁷

Thus far, only the Fifth and Eighth Circuits have analyzed preemption in the context of third-party sales of loans, but the

¹²⁰ See *id.* at 921–22.

¹²¹ *Id.* at 922–23.

¹²² See *id.* at 924, citing *Lattimore*, 656 F3d at 147–49.

¹²³ *Krispin*, 218 F3d at 924.

¹²⁴ *Id.*:

[T]he store's purchase of the bank's receivables does not diminish the fact that it is now the bank, and not the store, that issues credit, processes and services customer accounts, and sets such terms as interest and late fees. Thus, although we recognize that the NBA governs only national banks, in these circumstances we agree with the district court that it makes sense to look to the originating entity (the bank), and not the ongoing assignee (the store), in determining whether the NBA applies.

(citation omitted).

¹²⁵ See *id.* at 922–24.

¹²⁶ *Id.* at 925.

¹²⁷ See 12 CFR § 7.4008(e) (stating that state laws on the subject of contracts and torts, among other subjects, "are not inconsistent with the . . . lending powers of national banks and apply to national banks to the extent consistent with" NBA preemption doctrine).

Seventh Circuit has more generally adopted the once nonusurious, always nonusurious standard.¹²⁸ In assessing whether a nonusurious loan becomes usurious upon sale to an unregulated entity (which could not charge the same higher interest rate that the regulated entity could charge), Judge Richard Posner asked, “Why should the interest rate be lower if instead of collecting the debt directly the credit card company assigns (sells) the debt to another company, which hires the lawyer to collect it?”¹²⁹ Posner found no reason for this distinction; in fact, he asserted that specialization in the market (credit card companies specializing in originating loans and debt collectors specializing in collecting on delinquent debt) likely reduces the cost of credit for borrowers.¹³⁰ If, on the other hand, the loan becomes usurious upon the transfer to a debt collector, the originator itself will have to collect the debt and will pass on the higher cost to the borrower.¹³¹ Posner’s argument did not rest solely on an economic analysis of the law; he went on to support his holding by asserting that “once assignors were authorized to charge interest, the common law kicked in and gave the assignees the same right, because the common law puts the assignee in the assignor’s shoes, whatever the shoe size.”¹³² Lastly, and perhaps unpersuasively, Posner argued that the debtor should not receive the benefit of a lower interest rate upon default as that would create an incentive to default.¹³³

B. The Second Circuit Departs from Other Circuits: The NBA Is Inapplicable If a National Bank No Longer Owns the Loan

Against the administrative ease and economic rationale of the once nonusurious, always nonusurious doctrine, the Second Circuit determined in *Madden* that once a national bank is no longer affiliated with the loan, preemption by the NBA ends and state usury laws apply.¹³⁴ Before presenting the Second Circuit’s

¹²⁸ See *Olvera v Blitt & Gaines, PC*, 431 F3d 285, 289 (7th Cir 2005) (holding that once a lender has made a nonusurious loan, a subsequent owner is permitted to charge the original interest rate at common law).

¹²⁹ *Id.* at 287.

¹³⁰ See *id.* at 288.

¹³¹ See *id.*

¹³² *Olvera*, 431 F3d at 289.

¹³³ See *id.* While, on the margin, this assertion is likely correct, the debtor still maintains a significant incentive not to default, as default would force the debtor to incur higher interest rates in the future and may lead the debtor to enter costly bankruptcy proceedings.

¹³⁴ See *Madden*, 786 F3d at 250.

rationale in *Madden*, this Comment explores that court's prior NBA preemption jurisprudence.

1. The Second Circuit distinguishes between agency and nonagency relationships for the purpose of NBA preemption.

The Second Circuit has found that the NBA preempts state law when the state law fully forecloses the bank's opportunity to exercise its power. This standard was developed in several Second Circuit cases that attempted to implement the "significantly impairs" preemption standard adopted by the Supreme Court in *Barnett Bank*. In *SPGGC, LLC v Blumenthal*,¹³⁵ the court addressed whether the sale of prepaid gift cards violated a Connecticut statute that banned gift card inactivity fees and expiration dates.¹³⁶ SPGGC, an owner and operator of shopping malls, sold prepaid gift cards issued by a national bank.¹³⁷ Because the cards were sold by SPGGC, a non-national bank, but were issued via a national bank, the court first had to determine how to treat the relationship between SPGGC and the national bank.¹³⁸

NBA preemption analysis focuses on the power being wielded by the subsidiary and not the corporate structure of the entity.¹³⁹ However, because SPGGC was a separate entity and not a subsidiary, the court determined that preemption would generally not apply, though it acknowledged that "[i]t is possible that, in certain instances, a national bank's decision to carry out its business through an unaffiliated third party . . . might constitute an exercise of the bank's incidental powers under the NBA."¹⁴⁰ Because the court did not consider this relationship with a third party an exercise of a national bank's power, the court was left to "ask whether the regulation at issue actually affect[ed] the national bank's exercise of any authorized powers or whether it limit[ed] only activities of the third party which [were] otherwise subject to state control."¹⁴¹

¹³⁵ 505 F3d 183 (2d Cir 2007).

¹³⁶ Id at 186–87.

¹³⁷ Id at 186.

¹³⁸ See id at 189–90.

¹³⁹ See Part I.C.2. See also *Watters*, 550 US at 17 n 10 ("[F]or accounting and regulatory reporting purposes, an operating subsidiary is treated as part of the member bank; assets and liabilities of the two entities are combined.").

¹⁴⁰ *SPGGC*, 505 F3d at 190.

¹⁴¹ Id at 191.

The structure of the national bank's relationship with SPGGC was such that the bank made money via interchange fees (fees charged to a retailer when the card is used), whereas SPGGC made money on the fees associated with the card (including the monthly service fee).¹⁴² Given this structure, prohibiting SPGGC from charging these fees should not have conflicted with the national bank's power "to engage in [] offering 'electronic stored value systems.'"¹⁴³ The court noted the possibility that it might have come to a different conclusion, in line with the First Circuit's conclusion in a similar case, if the national bank had issued the gift cards itself.¹⁴⁴

On the issue of the cards' annual expiration, the court remanded because the national bank's relationship with Visa, the card processor, mandated the yearly expiration of the card as part of Visa's fraud-prevention program.¹⁴⁵ The court concluded that "an outright prohibition on expiration dates could have prevented a [national bank] from acting as the issuer of the [] Giftcard."¹⁴⁶ The court's analysis of the relationship was highly focused on how the economic relationship would impact the bank's ability to exercise its powers. Reducing or prohibiting SPGGC from collecting monthly fees would not directly impact the national bank; while SPGGC might respond by getting out of the business of issuing cards, the restriction would not directly prevent the bank from helping SPGGC issue those cards. In contrast, the prohibition against expiration dates would force the national bank out of the market because of its arrangement with Visa.¹⁴⁷

Similarly, the Second Circuit focused on the relationship between a national bank and a third party in *Pacific Capital Bank, NA v Connecticut*.¹⁴⁸ That case involved a challenge to a Connecticut law that limited the rate of interest an entity could charge on

¹⁴² See *id.* at 187.

¹⁴³ *Id.* at 189–90, quoting 12 CFR § 7.5002(a)(3).

¹⁴⁴ See *SPGGC*, 505 F3d at 191, citing *SPGGC, LLC v Ayotte*, 488 F3d 525, 533 (1st Cir 2007) (holding that the NBA preempted a similar New Hampshire law when a national bank issued and set the terms of the gift cards).

¹⁴⁵ *SPGGC*, 505 F3d at 187, 192 (noting that "to comply with Visa regulations, all [] Giftcards carried a one-year expiration date").

¹⁴⁶ *Id.* at 191.

¹⁴⁷ See *id.* at 191–92.

¹⁴⁸ 542 F3d 341 (2d Cir 2008).

a refund-anticipation loan.¹⁴⁹ The loan was originated by a national bank through a tax preparation service.¹⁵⁰ The national bank alleged that the NBA preempted the Connecticut regulation, and the court agreed.¹⁵¹ While the state argued that the law applied only to agents of the national bank, the court determined that the NBA allows national banks to exercise incidental powers through the use of agents.¹⁵² “A state statute that forbade national banks to exercise their incidental powers through agents would thus plainly be preempted. . . . [I]t [is] equally plain that a state statute cannot be allowed to avoid preemption by imposing such a prohibition indirectly.”¹⁵³ While the national bank could theoretically still make loans at a rate higher than that permitted by the Connecticut statute, the court concluded that “as a practical matter” the law either disallowed the national bank to use agents to make these loans or forced the bank to “forgo their NBA-permitted rates and limit themselves to the lower rates specified by” the Connecticut statute.¹⁵⁴ Again, the court’s focus seemed to be on the economic impact on the national bank—effectively, under the statute, the bank could not offer these loans at the rates it otherwise would have charged, much as the bank in *SPGGC* could not issue gift cards under the state statute prohibiting expiration dates.

2. *Madden* held that no agency relationship results from loan sales and that preemption does not apply to the purchaser.

The Second Circuit has established that NBA preemption may apply when a national bank employs an agent to carry out its powers and when applying state law to the agent would effectively prohibit the national bank from exercising its powers. In *Madden*, the Second Circuit was asked to determine whether NBA preemption of state usury laws continued after the sale of a loan to a non-national bank third party. The Second Circuit, distinguishing this case from *SPGGC* and *Pacific Capital Bank*, held

¹⁴⁹ See *id.* at 344–45 (“A refund anticipation loan . . . is a loan that is made to a taxpayer at or about the time of filing his or her income tax return and that is expected to be repaid to the lender directly from the proceeds of the borrower’s anticipated tax refund.”).

¹⁵⁰ *Id.*

¹⁵¹ *Id.* at 345.

¹⁵² See *Pacific Capital Bank*, 542 F3d at 352–53.

¹⁵³ *Id.*

¹⁵⁴ *Id.* at 353–54.

that declining to allow NBA preemption to transfer upon sale of a loan did not interfere with the exercise of a national bank's power to sell loans.¹⁵⁵

In holding that the NBA did not preempt the claim of usury, the Second Circuit looked to its holding in *SPGGC*. It compared the sale of loans to a third party to the monthly fee in *SPGGC*.¹⁵⁶ Just as regulating the fees that an agent of the national bank could charge in *SPGGC* would not have prevented the national bank from issuing the gift cards, regulating a third party's interest rate would not prevent the bank from selling the loans to the third party.¹⁵⁷ While the court admitted the possibility "that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states," the court believed that "such an effect would not 'significantly interfere' with the exercise of a national bank power."¹⁵⁸ Further, the court distinguished this case from *Pacific Capital Bank* on the basis that third-party debt buyers are not the bank's agents.¹⁵⁹ While the bank could employ an agent to collect the debt—at which point the Second Circuit suggested preemption would continue—once the national bank sold the loan, there would be no agency relationship, and as a result the NBA would not have preemptive effect.¹⁶⁰

Additionally, and contrary to Posner's economic analysis of the issue, the Second Circuit worried not about the cost of credit but rather about the overextension of preemption by allowing national banks to run around state usury laws.¹⁶¹ The Second Circuit's asserted policy goal led it to focus more on form than on substance; it distinguished *Madden* from the Eighth Circuit's opinion in *Krispin* based on the fact that in *Krispin* the national bank retained some ownership in the loan despite the fact that the non-national bank entity had the full economic risk of the loan.¹⁶² Effectively, the court seemed to suggest that had the national bank retained any interest in the loans (through, for example, maintaining a modest ownership interest, servicing the accounts, or setting ongoing terms for the extension of credit),

¹⁵⁵ See *Madden*, 786 F3d at 249–53.

¹⁵⁶ See *id.* at 251.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ See *Madden*, 786 F3d at 250–51, citing John C. Lyons Jr., *OCC Bulletin 2014-37* (OCC, Aug 4, 2014), archived at <http://perma.cc/3BUL-2AA6>.

¹⁶⁰ See *Madden*, 786 F3d at 250–51.

¹⁶¹ See *id.* at 251–52.

¹⁶² *Id.* at 252–53.

preemption would have been maintained.¹⁶³ But if the Second Circuit were really interested in adopting a policy of avoiding over-extensions of preemption, this modest difference in substance (some or minimal ownership compared to no ownership) does not perfectly capture the court's preference—the court may be allowing preemption in effectively identical situations, such as when a national bank sells substantially all of the loan, due to its focus on form over substance.

By holding that preemption is not applicable when a national bank sells its loan, the Second Circuit created a fundamental difference between its policy and the policies adopted in the Fifth, Seventh, and Eighth Circuits—those circuits created a bright-line rule that once a loan is nonusurious, the loan is always nonusurious. To the contrary, the Second Circuit holds that so long as a national bank maintains some modicum of ownership (broadly defined) in the loan, preemption is applicable, but once ownership is fully extinguished, the NBA ceases to apply. As a result, a petition for a writ of certiorari was filed with the Supreme Court,¹⁶⁴ but certiorari was denied.¹⁶⁵

C. Reckoning with the Different Interpretations

The split in authority between the Second Circuit and the Fifth, Seventh, and Eighth Circuits is implied by the language of the opinions in the Fifth, Seventh, and Eighth Circuits. The Fifth, Seventh, and Eighth Circuits have not directly confronted the issue of whether a complete sale of a loan by a national bank to a third party removes the NBA's preemptive effect on state usury laws. However, the sweeping language of those courts suggests that they would likely hold this to be the case, as they have adopted the proposition that a nonusurious loan does not lose its nonusurious quality upon transfer.

The Second Circuit attempted to distinguish these cases based on the full sale of the debt occurring in *Madden* (in which the Second Circuit found that the national bank maintained no ownership postsale) and some remaining ownership in the loans at issue in *Krispin*. Moreover, the Second Circuit characterized the bank in *Madden* as different from the bank in *Krispin* because

¹⁶³ See *id.* (noting that the bank did not retain an interest in the account, contrary to *Krispin*).

¹⁶⁴ See generally Petition for a Writ of Certiorari, *Midland Funding, LLC v Madden*, Docket No 15-610 (US filed Nov 10, 2015) (available on Westlaw at 2015 WL 7008804).

¹⁶⁵ *Midland Funding v Madden*, 2016 WL 3461580, *1 (US).

the bank at issue in *Krispin* “issue[d] credit, processe[d] and service[d] customer accounts, and set[] such terms as interest and late fees,” which gave the bank an interest in the loan absent primary ownership.¹⁶⁶

The cases are not as readily distinguishable as the Second Circuit made them seem. The Second Circuit claimed that, upon the sale of the debt, the national bank no longer has an interest in the loan. That is contrary to the typical transaction in which a seller sells an account to a third party: the seller of the account may still have a relationship with the buyer but not an interest in the loan once it is sold. For example, when someone purchases a car, the dealership or car manufacturer no longer has an interest in the car after the sale but may still have a relationship with the purchaser. Yet the Second Circuit failed to account for the *Krispin* national bank’s continuing relationship with May Department Stores in distinguishing *Krispin* from *Madden*. Because the national bank was a subsidiary of May Department Stores, the preemption framework outlined by the Court in *Watters* could be applicable—May Department Stores was merely carrying out the power of a national bank by acting as the bank’s agent. This distinction would help align the Second and Eighth Circuit decisions with Supreme Court precedent. Still, similar to *Madden*, the national bank subsidiary of May Department Stores was “required to maintain arms’-length transactions” with its parent.¹⁶⁷ While there was an ongoing relationship between May Department Stores and the national bank in *Krispin*, the arm’s length nature of the relationship makes it similar to *Madden*. However, there is no explanation as to why an ongoing relationship should be a basis for preemption but a subsidiary relationship should not. As such, the cases may not be as distinguishable as the agency theory may imply.

Furthermore, the Second Circuit’s rejection of the analogy to *Lattimore* is misplaced, similar to its rejection of the analogy to *Krispin*. *Lattimore* is *Madden* in reverse, and holds that the originator, not the buyer, determines the interest rate. While the facts are in reverse, the principle adopted in *Lattimore* can be applied to *Madden* to achieve a fundamentally different result. It is not clear why the principle in *Lattimore* should not be adopted in

¹⁶⁶ *Madden*, 786 F3d at 252, quoting *Krispin*, 218 F3d at 924.

¹⁶⁷ *Krispin*, 218 F3d at 923.

Madden. As such, the Second Circuit, by not adopting this principle, created a break from the Fifth, Seventh, and Eighth Circuits.

III. PREEMPTION APPLIES TO THIRD-PARTY SALES

The difference of opinion between the circuits raises an important question for both consumers and the financial industry.¹⁶⁸ The Second Circuit's analysis of conflict preemption was cursory and did not explore the full implications of not allowing the NBA to continue to be preemptive in the event of a sale to third parties. This Part first provides a fulsome preemption analysis and then analogizes to the common law and constitutional law to support the Fifth and Eighth Circuits' conclusions that the NBA should continue to be preemptive even after the sale of a loan to a third party. Finally, a transaction cost framework is presented to show that, contrary to the Second Circuit's and academics' assertions, the *Madden* holding may impact only the form and not the substance of debt sales to third parties. Effectively, national banks will employ methods to circumvent an inability to sell with preemptive effect. Those methods and the transaction costs associated with those methods will likely be passed on to consumers. Therefore, allowing preemption to continue upon sale may be not only the simplest solution but also the best one for consumers.

A. Standard Conflict Preemption Analysis Is Not Dispositive

While the Second Circuit in *Madden* determined that preemption did not continue because of the lack of an agency relationship, its preemption analysis focused on the sale of a defaulted loan, and, as a result, the opinion did not investigate the implications of the holding on other national bank powers. This Section conducts a more robust preemption analysis regarding all of the potential powers implicated by disallowing preemption posttransfer. This Section starts by confirming that preemption analysis is applicable in this scenario, and it then proceeds to determine the national bank powers that are implicated by loan sales. This Section concludes by showing the potential divergence of opinion regarding whether restricting preemption to only national banks severely impairs any of the identified powers.

¹⁶⁸ See Brief for Plaintiff-Appellant, *Madden v Midland Funding, LLC*, Case No 14-2131, *39–42 (2d Cir filed Aug 15, 2014) (available on Westlaw at 2014 WL 4180161) (asserting that the continuation of preemption after transfer would circumvent recent congressional actions to protect consumers).

1. Preemption analysis is applicable.

Before determining which way preemption analysis cuts, the preliminary question whether preemption analysis applies to loan sales by a national bank to a third party must be answered. The usury laws at issue are being enforced against a third party, not against a national bank. Most circuits agree that the NBA still preempts state laws even if the law is enforced against only a non-national bank, because it may impact a national bank. The Supreme Court has never clearly ruled on this issue, but *Watters* is persuasive here, as it sets out national bank powers as the focal point of a preemption analysis.¹⁶⁹ Some commentators have suggested that, under then-current case law, while the NBA would apply to regulation of a national bank's counterparties, such regulation would not have preemptive force.¹⁷⁰ However, such analysis has not generally taken the holdings of *Krispin* or *Lattimore* into account in the context of state usury laws.¹⁷¹ Further, even the Second Circuit agrees that, in some instances, the NBA can preempt state laws enforced against non-national banks.¹⁷² Regulation of national banks' counterparties, especially regulation aimed at changing the national banks' behavior, likely implicates the NBA.¹⁷³ Accordingly, a conflict preemption analysis is in order.

2. Third-party sales implicate powers of national banks.

Prior to determining whether the NBA preempts state usury laws, it is necessary to identify the powers of national banks that could conflict with state usury laws. The power to charge an interest rate that is permissible in the state where the bank is located may be implicated by the application of state usury laws to

¹⁶⁹ See *Watters*, 550 US at 18–19 (affirming a focus on powers by asserting that “[s]ecurity against significant interference by state regulators” should adhere to all powers of a national bank regardless of where within the corporate structure the business is conducted).

¹⁷⁰ See, for example, Adam J. Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 Yale J Reg 143, 208–10 (2009).

¹⁷¹ See *id.*

¹⁷² See *SPGGC*, 505 F3d at 190 (finding it possible that “a national bank’s decision to carry out its business through an unaffiliated third party such as SPGGC might constitute an exercise of the bank’s incidental powers under the NBA”).

¹⁷³ See, for example, *Pacific Capital Bank*, 542 F3d at 353:

If a state statute subjects non-bank entities to punishment for acting as agents for national banks with respect to a particular NBA-authorized activity and thereby significantly interferes with national banks’ ability to carry on that activity, the state statute does not escape preemption on the theory that, on its face, it regulates only non-bank entities.

third parties, but other powers of a national bank are also implicated.¹⁷⁴ A national bank has the power to “make, sell, purchase, participate in, or otherwise deal in loans and interests in loans that are not secured by liens,”¹⁷⁵ as well as the power to sell and securitize loans¹⁷⁶ and to sell loans associated with real estate lending.¹⁷⁷ Effectively, Congress has given national banks the ability to lend money at the interest rate allowed in the state where they are located, freely trade loans, and, if necessary, sell loans for the purpose of securitization. All of these powers are potentially implicated if preemption does not follow loans made by national banks.

3. The effect on national banks’ powers is significant.

When state laws potentially impact a national bank’s power, a preemption analysis is warranted. In Dodd-Frank, Congress clarified that a court’s inquiry in an NBA-preemption case is governed by the “prevents or significantly interferes” standard from *Barnett Bank*.¹⁷⁸ This question, whether a state law “significantly interferes” with a national bank’s power, is intensely fact-specific, and courts’ decisions in these cases generally rest on their characterizations of the power and the interference. The Second Circuit’s characterization of the impairment in *Madden* is emblematic. In *Madden*, the court saw the harm as changing the price at which banks could sell their debt, not an inability to sell debt.¹⁷⁹ The impairment in *Madden* can be analogized to the types of impairments found in other cases. For example, the Ninth Circuit found that the NBA preempts state laws prohibiting banks from charging nondepositors ATM fees.¹⁸⁰ The question that the Second

¹⁷⁴ It may be necessary to clarify at this time that the mere fact that a national bank is granted the power to do something does not mean that other types of entities will not have the same or similar powers. For example, national banks are allowed to issue loans, but so are state banks. Regardless, the focus of preemption analysis is the powers granted to national banks by Congress, *not* those powers relative to the powers of other entities.

¹⁷⁵ 12 CFR § 7.4008(a).

¹⁷⁶ 12 CFR § 1.3(g) (“A national bank may securitize and sell assets that it holds, as a part of its banking business.”).

¹⁷⁷ 12 USC § 371(a).

¹⁷⁸ See notes 60 and 77–80 and accompanying text.

¹⁷⁹ See *Madden*, 786 F3d at 251 (asserting that applying “state usury laws would not prevent consumer debt sales by national banks to third parties,” but admitting that “it is possible that usury laws might decrease the amount a national bank could charge for its consumer debt in certain states”).

¹⁸⁰ See *Bank of America v City and County of San Francisco*, 309 F3d 551, 561–66 (9th Cir 2002) (holding that the power to charge fees was in conflict with state laws preventing national banks from charging ATM fees).

Circuit addressed in *Madden* is similar to the question in the Ninth Circuit case—whether a state’s usury laws prevent a bank from charging an interest rate that it is permitted to charge under the NBA.

Similarly, courts have recently held that the NBA has preemptive effect with regard to check-cashing laws. These laws provide that a bank must cash a check at par value.¹⁸¹ Courts have held that state laws prescribing that banks cash checks at par are in conflict with regulations promulgated by the OCC under the NBA.¹⁸² These state laws do not stop a national bank from charging fees but rather prohibit a specific type of fee. Similarly, in the case of loan transfers, holding that preemptive effect does not carry over may not stop a national bank from selling the debt; it will just restrict or impair the bank’s ability to do so. While in the check-cashing cases the OCC’s interpretation of “customers” was at issue,¹⁸³ the courts nonetheless held that the OCC’s interpretation was warranted and that state laws “prohibit[ed] the exercise of a power which federal law expressly grants the national banks.”¹⁸⁴ *Madden* is a similar case, albeit without an interpretation by the OCC: The NBA permits a national bank to sell loans.¹⁸⁵ Allowing the loan transfers to decrease the permissible interest rate impairs the bank’s ability to sell those loans, though it does not eliminate the ability—just as regulating the amount for which a bank can cash a check does not prevent the bank from imposing other fees on its customers. However, in the check-cashing cases, the Fifth and Eleventh Circuits saw such an activity as impeding the powers of a national bank and, as such, determined that the NBA was preemptive. Similar logic should apply upon the transfer of a loan.

The Supreme Court has not drawn a clear line as to what constitutes “significant impairment” of a national bank’s power. As shown above, the characterization of the facts is important,

¹⁸¹ See *Baptista v JPMorgan Chase Bank, NA*, 640 F3d 1194, 1196 (11th Cir 2011); *Wells Fargo Bank of Texas NA v James*, 321 F3d 488, 489 (5th Cir 2003). See also Tex Bus & Comm Code Ann § 4.112.

¹⁸² See, for example, *Baptista*, 640 F3d at 1196–98, citing 12 CFR § 7.4002(a) (providing a national bank with the authority to “charge its customers non-interest charges and fees, including deposit account service charges”).

¹⁸³ See *Wells Fargo Bank of Texas*, 321 F3d at 492–95 (holding that the effect of the regulation was preemptive only to the extent that “Congress meant to delegate to the OCC the discretionary authority embodied in [12 CFR § 7.4002(a)]”).

¹⁸⁴ *Id.* at 495. See also *Baptista*, 640 F3d at 1198.

¹⁸⁵ See 12 CFR § 7.4008(a).

and judges may import their policy preferences into the characterization of the facts to obtain their desired outcomes. In close cases, any potential to definitively answer the preemption question by characterizing the facts in a certain way seems dissatisfying and can likely be improved upon by looking for alternative paths of analysis. In that vein, *Marquette* provides another avenue for preemption analysis.

The petitioners in *Marquette* claimed that a national bank should be considered located wherever the creditor does business.¹⁸⁶ The Court rejected this because it would “throw into confusion the complex system of modern interstate banking” and create a great deal of uncertainty for national banks when they originated loans.¹⁸⁷ Similarly in the context of third-party loan sales, banks would need to take into account the debtor’s location when selling the loan and, potentially, when originating the loan. Perhaps more worrisome is that the bank would need to track the debtor (in this case a defaulted debtor), as it is unclear which state’s usury law would apply: the state where the debtor opened the account, the state where the debt was sold, or the state where the debtor brought his usury claim. While the debt buyer may be more concerned about this ambiguity, the bank would also need to be concerned in order to provide the potential debt buyer with this information. Such an administratively complex system predicated on the application of state law may run afoul of the prescription in *Marquette*.

Lastly, national banks, in addition to having the power to sell loans, have the power to securitize assets. In general, securitizations occur when a bank pools assets together (in this case, loans) and sells them to a special purpose vehicle (SPV). The SPV is able to purchase these assets from the bank by issuing debt to investors. Securitizations generally occur shortly after the origination of loans, at which point the bank sells the loans at par (that is, at 100 cents on the dollar).¹⁸⁸ If preemption were not carried forward, then the bank either could not securitize certain assets (assets that would be usurious once owned by a non-national bank entity) or would have to stop underwriting loans at an NBA-permissible rate if it wanted to securitize those loans. Either way, the national bank’s ability to securitize loans would be hampered.

¹⁸⁶ See *Marquette*, 439 US at 310.

¹⁸⁷ *Id.* at 312.

¹⁸⁸ Frank J. Fabozzi and Vinod Kothari, *Securitization: The Tool of Financial Transformation* *3 (Yale ICF Working Paper No 07-07), archived at <http://perma.cc/SH7Q-MTUG>.

In fact, the effect would be similar to what the Second Circuit observed in *Pacific Capital Bank*. In that case, because usury laws were enforced on the bank's agent, the bank was forced to either not make loans or make loans at a rate below the rate allowed under the NBA.¹⁸⁹

Similarly, in the securitization context, if preemption does not continue after the sale of the asset to a third party, the bank will have to either get out of the business of securitization or (more likely) lend to some consumers at rates below the rate allowed under the NBA. The same choice presented in *Pacific Capital Bank* exists in this situation, but the choice is starker. Conceivably, in *Pacific Capital Bank*, the bank could have set up a tax return business that, in addition to filing tax returns, offered refund-anticipation loans. Here, on the contrary, if the Second Circuit's holding stands, a national bank would not be able to perform one of its powers—securitization—without taking the state usury laws into account.

4. Through the NBA, the federal government is imposing a price cap on national banks that should not change upon sale.

Usury laws can be conceptualized as price caps—the permissible interest rate is the price ceiling for a national bank. This price cap inevitably affects the price at which banks can purchase (underwrite) and sell loans. In this sense, allowing individual state usury laws to apply to national banks has the same effect as allowing individual state check-cashing laws to apply—it restricts national banks' ability to exercise their power. While state usury laws may be viewed as background contract principles that are generally exempt from preemption absent explicit federal law intervention,¹⁹⁰ they are in fact another form of consumer protection laws.¹⁹¹ Allowing state usury laws to control the sale or transfer

¹⁸⁹ See text accompanying note 154.

¹⁹⁰ See 12 CFR § 7.4008(e) (declaring that state contract law is not generally preempted).

¹⁹¹ The distinction between contract law and consumer protection law is a legal question. However, the notion that usury laws should be regarded as a type of consumer protection law is supported by the fact that they are usually enacted by state legislatures, rather than derived from the common law, see Hill, Note, 6 NC Bank Inst at 421–22, 426 (cited in note 82), as well as the fact that the Restatement (Second) of Contracts does not discuss usury laws.

of debt would “impose state requirements that differ[] from” federal law.¹⁹²

The case for federal preemption of usury laws is, in many respects, no different from the case for federal preemption of state tort claims in medical-device cases.¹⁹³ In the medical-device space, the federal government has set a minimum safety standard and has preempted state laws to the extent they impose a higher standard on the device manufacturer, as allowing states to impose higher standards would “disrupt[] the federal scheme.”¹⁹⁴ This makes sense—if every state imposed some higher safety standard, medical-device manufacturers would be forced to either produce fifty different products or, more likely, conform to the highest safety standard. States would be able to regulate in an area in which the federal government has made clear that there should be only national regulation.

Similarly, the NBA was enacted to create a federal banking scheme insulated from state interference.¹⁹⁵ Just as the federal government set national safety standards for medical devices, the NBA sets standards for national banks, including a price cap on the products they offer. In the medical-device field, allowing state law to increase safety standards may lead to state law superseding federal law in application. In medical devices, the worry is that states will raise the safety floor. In the national bank context, the worry is that states will lower the usury ceiling. National law must, then, preempt state law. Otherwise, the fear of state law creeping into and dominating an area in which the federal government has established a national rule is likewise apparent.

But the Court has acknowledged that there are occasions when state regulation of medical devices is not preempted. According to the Tenth Circuit’s interpretation of Supreme Court precedent, when the duty owed by manufacturers under state law parallels the duty owed under the federal law, the federal law

¹⁹² *Riegel v Medtronic, Inc.*, 552 US 312, 321 (2008), quoting *Riegel v Medtronic, Inc.*, 451 F3d 104, 121 (2d Cir 2006).

¹⁹³ It should be noted that in medical-device cases, the national law at issue does not look to state law for its national effect. However, the purposes of both laws are similar, and, as such, the analogy is apt. To be sure, there are differences between the regulation of medical-device manufacturers and national banks. For example, the NBA creates a dual banking system while federal law universally governs medical-device manufacturing. Nevertheless, the analogy is fitting—the fundamental purpose of each set of regulations is to relieve an industry from the burdens of individual state laws and to allow the federal government to determine a national policy.

¹⁹⁴ See *Riegel*, 552 US at 323–26.

¹⁹⁵ See Part I.A.

does not preempt state law.¹⁹⁶ In providing some clarity on what types of laws parallel state laws, the Court's decisions, as interpreted by the Tenth Circuit, have specified that state and federal laws parallel one another "not only when they are identical, but also when state law imposes duties on the defendant that are 'narrower, not broader' than those" imposed by federal law.¹⁹⁷ For example, if federal law imposed a strict liability regime on a medical-device manufacturer but state tort law imposed a negligence standard, all else equal, the laws would parallel each other because the state law was "narrower" than the federal law.¹⁹⁸

Admittedly, this analysis applies imperfectly to the NBA context. Medical devices are traditionally national products produced for a national consumer base.¹⁹⁹ And while the growth in national banks means that large multistate banks dominate the lending market today, historically bank loans have been more local in scope.²⁰⁰ Nonetheless, the analogy helps clarify how the Court employs preemption analysis to a law meant to create a uniform system of regulation. And, while not discussed in any court, a medical-device manufacturer does not lose the preemptive force of federal law because it sells the product into the market. Medical devices are regulated for the purpose of being put into the market and used by medical practitioners—eliminating preemption upon the transfer of the device would negate the purpose of the enterprise. Applying the analogy to national banks, the loans underwritten by the banks are similarly conceived of as products to be put into the market.

Loans may not typically be thought of as products, but from the banks' perspective, loans are a product they are selling. Banks compete on price just as manufacturers do; the price just happens

¹⁹⁶ See *Caplinger v Medtronic, Inc.*, 784 F3d 1335, 1338 (10th Cir 2015), citing *Medtronic, Inc v Lohr*, 518 US 470, 495 (1996).

¹⁹⁷ *Caplinger*, 784 F3d at 1338, quoting *Medtronic*, 518 US at 495.

¹⁹⁸ *Caplinger*, 784 F3d at 1338.

¹⁹⁹ See, for example, ResMed Inc, *Form 10-K Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the the Fiscal Year Ended June 30, 2015* *13 (SEC, Aug 6, 2015), archived at <http://perma.cc/6PCH-TG5A> (noting that, as a medical-device manufacturer, the company "attempt[s] to tailor [its] marketing approach to each national market") (emphasis added).

²⁰⁰ See Mitchell A. Petersen and Raghuram G. Rajan, *Does Distance Still Matter? The Information Revolution in Small Business Lending*, 57 J Fin 2533, 2533–34 (2002) (observing that historically "the decision to offer credit has to be made very close to where the information is gathered," but that from 1973 to 1993 "the physical distance between small firms and their lenders [grew] steadily").

to be the interest they charge. There is nothing conceptually different about what manufacturers and banks are doing—the former sell products and the latter sell money, but they both sell something. In a medical-device case, an injured patient could not sue the doctor due to the medical device’s malfunction if the device adhered to the federal regulation. Similarly, the preemption of usury in the NBA should not fall because of the sale of the bank’s product—a loan. Applying the same logic that the Supreme Court applied to medical devices supports a finding of preemptive effect.

5. Preemption analysis, and the “significantly impairs” test specifically, does not yield a conclusive answer.

Despite the above analysis, how best to interpret preemption of state usury laws remains unclear. Some commentators have suggested that state regulators can regulate bank counterparties to prevent a bank from exercising some powers, such as the power to sell loans to third parties.²⁰¹ However, these commentators admit that regulating a national bank’s counterparty (in this case by enforcing state usury laws) “might constrict the secondary market for consumer debt and thereby lower the resale price of the debt.”²⁰² At first blush, this does not appear to be regulating the national bank but instead modestly changing the market for the bank’s credit. Yet this change may have broader implications: reducing the price at which banks can sell loans into the secondary market may incentivize banks to change the terms of their initial loans. Therefore, by regulating counterparties, states are implicitly regulating national banks²⁰³—an outcome the NBA was enacted to avoid.

In terms of formal preemption analysis, the question is at what point state laws “significantly impair” the bank’s ability to sell loans and to set the terms for loans. In *Madden*, the court found that allowing state usury laws to apply to third-party debt purchasers would “limit[] only activities of the third party which are otherwise subject to state control.”²⁰⁴ On the surface, the argument that a decrease in the interest that can be charged from

²⁰¹ See, for example, Levitin, 26 Yale J Reg at 208–10 (cited in note 170).

²⁰² Id at 209.

²⁰³ See id at 208–10 (arguing that regulation of banks’ counterparties may impact the terms at which banks originate loans).

²⁰⁴ *Madden*, 786 F3d at 251, quoting *SPGCC*, 505 F3d at 191 (brackets in original). As discussed in Part III.C, this assumption is likely faulty—the finding of preemption will

27 percent to 25 percent likely does not “significantly impair” a bank’s ability to either originate or sell loans is persuasive. But there are two problems with this line of reasoning. First, following this reasoning to its logical extreme would allow state usury laws to creep from just impairing a bank’s ability to originate and sell loans to “significantly impairing” a bank’s ability to originate and sell loans—line drawing in this case would have to turn on the specific facts of the state’s laws, the national bank’s location, and the amount of business a bank does in the state. Moving forward in this fashion would be cumbersome, but a focus solely on the preemption analysis leads to this conclusion. If the Second Circuit’s logic is pushed to this extreme, fact finding regarding what significantly harms a national bank would best be left to either Congress or the OCC.

Second, this line of reasoning belies the realities of bank regulation. The Second Circuit has admitted that applying state usury laws to third-party sales “might decrease the amount a national bank could charge for its consumer debt in certain states.”²⁰⁵ Stopping there, the court found that this decrease in price would not “significantly interfere” with a national bank’s powers.²⁰⁶ The reality of bank regulation offers a more complex view.

Several US regulators, including the OCC, the Federal Reserve, and the FDIC, regulate national banks. This regulation is done via minimum-capital requirements.²⁰⁷ Effectively, regulators force banks to risk weight their assets and to hold capital against their assets on a risk-weighted basis. Risk weights encourage certain types of lending over others.²⁰⁸ Regulators have chosen risk weighting as a way to confront the inevitable moral hazard problem in banking—government insurance, in the form of deposit insurance and bailouts, allows banks to take excess risk

increase transaction costs but likely will not change the price at which banks can sell the loans. Rather, these increased costs (the costs of transacting around preemption not flowing to third-party debt purchasers) will be pushed onto consumers through a variety of mechanisms—for example, through higher interest rates, higher default rates, and increased fees. Nevertheless, this Section assumes that the Second Circuit’s logic—the logic applying usury fees to third-party sales—holds true, but it finds that the Second Circuit stopped too soon in its analysis.

²⁰⁵ *Madden*, 786 F3d at 251.

²⁰⁶ *Id.*

²⁰⁷ See Eric A. Posner, *How Do Bank Regulators Determine Capital-Adequacy Requirements?*, 82 U Chi L Rev 1853, 1866–72 (2015) (describing the modern bank-regulatory scheme).

²⁰⁸ See *id.* at 1881–82.

because the bank captures the upside but is insured on the downside by the government.²⁰⁹ The risk weights are expected to proxy the riskiness of the loans. So, for example, a US Treasury bill will have a risk weight lower than a loan to a highly indebted corporate borrower.²¹⁰ The risk weight is then multiplied by the face value of the loan. To continue the example, if a bank held \$100 of US Treasury bills and \$100 in risky corporate loans with risk weights of 20 percent and 150 percent, respectively, the bank would have risk-weighted assets of \$170 on \$200 of assets at face value.

Once a bank determines the amount of risk-weighted assets it holds, it must then ensure that it has enough capital relative to its risk-weighted assets. Here, regulators provide a rule, such as a 7 percent capital ratio. The capital–asset ratio represents the amount of equity a bank must hold relative to its risk-weighted assets. In the above example, if the required capital–asset ratio were 7 percent, the bank would need to hold \$11.90 of capital. This capital represents the amount of downside risk a bank can withstand—the value of the bank’s risk-weighted assets can decline by 7 percent before the bank will be insolvent. The price other banks will pay for defaulted loans (like those at issue in *Madden*) with high capital requirements, and thus high equity requirements, is limited by the capital requirements—a lower price will increase the expected return and may make the purchase attractive despite the large capital requirements.

After the global financial crisis of 2008, US regulators imposed updated risk-weight requirements on banks.²¹¹ Presently, a ninety-day defaulted, unsecured loan has a risk weight of 150 percent.²¹² This means that for every \$1 of defaulted debt, a bank must hold \$1.50 of equity.²¹³ Effectively, the expected return on

²⁰⁹ See *id.* at 1860.

²¹⁰ See *id.* at 1869.

²¹¹ See Posner, 82 U Chi L Rev at 1871 (cited in note 207).

²¹² See Office of the Comptroller of the Currency and Board of Governors of the Federal Reserve System, Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule, 78 Fed Reg 62018, 62090 (2013), amending 12 CFR § 3.32(k) (establishing a rule that “a banking organization must apply a 150 percent risk weight to all past-due [unsecured] exposures”).

²¹³ This assumes that the capital ratio is 100 percent. While this is an unrealistic assumption, it enhances the ease of the foregoing analysis. Using a more realistic capital ratio would not significantly change the outcome of the analysis.

defaulted debt will be significantly reduced because of the increased capital requirement. Assume that the initial risk weight on the asset was 100 percent, so that for each \$1 of loan, the bank held \$1 of equity. If the expected return on the loan were 10 percent, the bank would expect a 10 percent return on its equity, because the loan was fully funded with equity.²¹⁴ If the creditor defaults, the risk weight would jump to 150 percent (such that the bank would then need to fund the loan with \$1.50 of equity for every \$1 of loan). That will reduce the bank's return to 6.67 percent, assuming the expected return of the loan remains constant.²¹⁵

This has implications for the price of the loan that a bank in the Second Circuit (under *Madden*) is attempting to sell. Other banks²¹⁶ will not be able to purchase the debt at its intrinsic value because of this regulation, so debt purchasers may be the only natural buyers left. At this point, nonbank debt purchasers have a solid advantage over banks in the market for these loans: they can already drive the price down, and allowing usury laws to apply to their purchases will only decrease the price they are willing to pay.

This discussion ends where it started—the extent to which applying usury laws to debt sold by a national bank will impair the bank's ability to exercise its powers is an empirical question. Under the Second Circuit's analysis, a court's ability to answer such a question will either require extensive expert analysis or deferral to administrative agencies or Congress. As a result, turning to other analogies and analyses of this issue may create a more robust and administrable solution for courts. Of course, the Court has not typically used this line of analysis, instead resting on a more formalized idea of whether the application of state law conflicts.²¹⁷ However, turning to other analogies in the next Sections—including to the common law, to constitutional law, and to

²¹⁴ Allowing risk weights of less than 100 percent allows the bank to put leverage on its assets, which will increase the simple expected return. However, for the purpose of ease and clarity, this example assumes a 100 percent risk weight.

²¹⁵ The bank originally put up \$1 of equity for every \$1 of loan, at an expected return of 10 percent. So, for every \$1 of equity, the bank expected 10 percent in return. When the risk weight increases, the bank will then have \$1.50 of equity for every \$1 of loan, still with an expected return of 10 percent. Ten percent of \$1 is only 6.67 percent of \$1.50, so the bank's new expected return will decrease.

²¹⁶ Capital requirements apply to all banks, not just national banks. Therefore, the reduction in the market for defaulted debt may be significant since this analysis will apply to all banks.

²¹⁷ See, for example, *Barnett Bank*, 517 US at 42–43.

a transaction cost framework—may help provide further support to this analysis.

B. Common-Law Precedent and Constitutional Principles in the Contract Clause Generally Support Preemptive Effect

Prior to the passage of the NBA, the Supreme Court issued various rulings indicating that a loan, once nonusurious, could not become usurious upon a subsequent transaction. Congress legislated against this backdrop. While none of these cases has facts similar to *Madden*, some suggest in dicta that the Court has always presumed that a loan's usurious quality could be assessed only at the time of origination. Common-law precedent is bolstered by indications that the Court views the NBA as a national law governing contracts. As such, allowing state usury laws to impair a contract may run afoul of the Contract Clause of the Constitution.²¹⁸ This Section first explores the common-law precedent and applies it to the question of preemption. Then, this Section examines questions related to the fact that the NBA could be interpreted as a federal law governing a contract, specifically discussing choice-of-law rules and the Contract Clause.

1. Contract law confirms that a transaction, once nonusurious, cannot be made usurious by subsequent transactions.

The early nineteenth-century Court addressed the issue of usury in broad language. These cases generally involved allegations of usury as a result of a discount on a note from the original holder to a third party.²¹⁹ Essentially, the claim was that while the original interest rate was nonusurious, the note became usurious because the third party's rate of return would be higher than allowed by state law once the discount was taken into account. In multiple cases, the Supreme Court rejected this notion and noted in dicta that "the rule cannot be doubted, that if the note be free

²¹⁸ US Const Art I, § 10, cl 1.

²¹⁹ See generally, for example, *Gaither v Farmers and Mechanics Bank of Georgetown*, 26 US (1 Pet) 37 (1828); *Moncure v Dermott*, 38 US (13 Pet) 345 (1839). A discount is the amount by which the face value of the note exceeds the price that is paid by the buyer of the note. For example, a note with a face value of \$100 that is sold for \$90 has a discount of \$10.

from usury, in its origin, no subsequent usurious transactions respecting it, can affect it with the taint of usury”²²⁰ and that “a contract, which, in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction.”²²¹ Perhaps most explicitly, the Court stated that “[i]f the bond was free from usury in its inception, no subsequent transaction between other parties could invalidate it.”²²² And in the canonical case of *Ogden v Saunders*,²²³ the Court propounded that usury laws “declare [a] contract to be void in the beginning,” not after the contract has been established.²²⁴

Despite the Court’s strong language, these holdings are persuasive but not absolute authority on the matter of usury—these cases are set in a historical context in which notes traded freely between parties and were used as a form of currency.²²⁵ Prohibiting appropriate discounting of the notes in the nineteenth century would have reduced the amount of currency within the system and could have caused a run on coin money. However, modern contract law provides further support that, once a nonusurious loan is made, its nonusurious character is maintained in perpetuity. Historically, “[a]t common law, an assignee of a chose in action could enforce its right at law only in the name of the assignor.”²²⁶ While having to sue in the name of the assignor has become a historical relic, it provides some insight into the current dispute. Modern contract law allows a party to freely assign the right of the other party’s performance to someone else.²²⁷ In fact, the Uniform Commercial Code specifically allows a party to alienate his portion of the contract unless “the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance.”²²⁸ Not only can the contract be assigned but the damages resulting from a

²²⁰ *Gaither*, 26 US (1 Pet) at 43.

²²¹ *Nichols v Fearson*, 32 US (7 Pet) 103, 109 (1833).

²²² *Moncure*, 38 US (13 Pet) at 356.

²²³ 25 US (12 Wheat) 213 (1827).

²²⁴ *Id* at 348.

²²⁵ See Laurence Ales, et al, *A Model of Banknote Discounts* *2 (Federal Reserve Bank of Minneapolis Working Paper No 641, Mar 2006), archived at <http://perma.cc/M7R6-H5A8>.

²²⁶ Samuel Williston and Richard A. Lord, 29 *A Treatise on the Law of Contracts* § 74:55 at 582 (West 4th ed 2003) (citation omitted).

²²⁷ See Restatement (Second) of Contracts § 317 (1979).

²²⁸ UCC § 2-210(2).

breach of contract can also be assigned.²²⁹ Allowing parties to freely alienate their contractual rights allows those rights to flow to their highest-valued use.²³⁰ Contract law has always presumed that “the assignee steps into the shoes of the assignor, assuming his rights as well as his duties.”²³¹

While hearkening back to mid- and late nineteenth-century cases risks the claim of irrelevance, the Court has relied on and cited older cases in ruling on NBA preemption.²³² The Court may be looking to these older cases because preemption focuses on congressional intent, and, given the limited legislative history available from 1864, these cases provide some of the best evidence of such intent. The decision in *Marquette* exemplifies the point: finding a lack of directly relevant legislative history, the Court turned to historical Supreme Court cases to support its inferences about what Congress knew about banking and how it intended the NBA to apply.²³³ Additionally, allowing claims to transfer with the same rights that the original contracting party had is a feature of both historical and modern contract law. While Congress adopted state usury laws, it did so against the backdrop of existing contract law, which adopted the once nonusurious, always nonusurious principle. As a measure of congressional intent and background rules governing contractual relationships, the once nonusurious, always nonusurious principle has ample support. Reading the NBA with this backdrop supports the transfer of the rights the contract has when initiated and allows preemption to continue postsale.

²²⁹ UCC § 2-210(2) (“A right to damages for breach of the whole contract or a right arising out of the assignor’s due performance of his entire obligation can be assigned despite agreement otherwise.”).

²³⁰ See R.H. Coase, *The Problem of Social Cost*, 3 J L & Econ 1, 15 (1960) (declaring famously that “[i]t is always possible to modify by transactions on the market the initial legal delimitation of rights”).

²³¹ *Olvera v Blitt & Gaines, PC*, 431 F3d 285, 288 (7th Cir 2005).

²³² See, for example, *Marquette*, 439 US at 308, citing *Farmers’ and Mechanics’ National Bank v Dearing*, 91 US 29, 34 (1875); *Barnett Bank*, 517 US at 32 (citing historical cases for the purpose of establishing that the history of the NBA “is one of interpreting grants of both enumerated and incidental ‘powers’ to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law”); *Smiley v Citibank (South Dakota), NA*, 517 US 735, 745–46 (1996), citing *Craig v Pleiss*, 26 Pa 271, 272–73 (1856) (finding support from mid-nineteenth-century cases for a definition of “interest rates,” under the NBA, that includes late fees); *Watters*, 550 US at 11–12, citing *Farmers’ and Mechanics’ National Bank*, 91 US at 34 (finding support for the notion that exercise of state control over national banks is a usurpation of the national banks’ power).

²³³ See *Marquette*, 439 US at 318.

2. The NBA is a federal law that governs the contract from inception until completion.

Historical and modern contract law seem to suggest that usury is a question best decided at the inception of a contract. These issues involve questions of state law. While a generalization of the common law supports the adoption of the once nonusurious, always nonusurious policy, state courts may attempt to invoke the public policy of their states to find the usury laws of other states inapplicable.²³⁴

The potential for courts to invoke public policy to enforce their states' usury laws may suggest that common-law analogies do not fully support allowing preemption to continue. This assumes that state law fully governs the loan contract, and the Supreme Court has suggested—though never fully confirmed—that the NBA and the usury law associated with it are national law, *not* state law. As such, the invocation of state law to hold the transferred loan usurious may conflict with choice-of-law principles and the Contract Clause.

There are many reasons why Congress may seek to incorporate state law into federal law, but regardless of the reason, “state law is generally borrowed with the understanding that it should serve federal interests.”²³⁵ The law governing the interest rate in a contract originating between a national bank and a debtor is federal law, and by means of 12 USC § 85, federal law imposes a choice-of-law rule on the contract's interest rate: the law of the state where the bank is located governs. As national law governs the contract at inception, and the interest rate provision in particular, that law should continue to govern even upon the sale. As discussed above,²³⁶ basic contract law asserts that the rights of an assignor flow to the assignee and, as a result, the federal choice-of-law rule with respect to interest rate should continue to apply posttransfer.

If federal law governs the contract at inception, then there are two potential theories that explain why federal law should continue to control upon a sale to a third party. The first is a

²³⁴ For an example of a court invoking its state's public policy to invalidate a contract, see *In the Matter of Baby M*, 537 A2d 1227, 1246–50 (NJ 1988) (holding a surrogacy contract invalid because it conflicted with the public policy of the state).

²³⁵ Radha A. Pathak, *Incorporated State Law*, 61 Case W Res L Rev 823, 846 (2011). Examples of federal laws that incorporate state laws include the Federal Tort Claims Act and the Foreign Sovereign Immunities Act. *Id.* at 839.

²³⁶ See notes 227–31 and accompanying text.

choice-of-law theory—the parties at the time of contract formation stipulated that federal law, for the purposes of the defense of usury, would apply. The Supreme Court has settled the issue of choice-of-law provisions relating to usury:

The general principle in relation to contracts made in one place to be performed in another is well settled. They are to be governed by the law of the place of performance, and if the interest allowed by the law of the place of performance is higher than that permitted at the place of the contract, the parties may stipulate for the higher interest without incurring the penalties of usury.²³⁷

In non-NBA cases, courts continue to enforce choice-of-law provisions allowing parties to stipulate which state's usury laws will apply. When parties claim a usury defense that is not applicable under the chosen law, courts have rejected their claims.²³⁸ By adopting state law within the NBA, Congress applied a choice-of-law rule with respect to usury defenses—the choice-of-law rule should not change because of the transfer of the contract. And, as the Court has noted, the NBA provides the “exclusive cause of action for such claims” of usury against national banks.²³⁹ Thus, Congress's rule is the exclusive rule for the disposition of these cases.

A second theory relates to both the Supremacy Clause and the Contract Clause of the US Constitution. The Contract Clause prevents a state from enacting a law that “impair[s] the [o]bligation of [c]ontracts.”²⁴⁰ Initial support for the Contract Clause applying to third-party sales comes from *Ogden*, in which the Court suggested that usury laws apply only at the inception of the contract.²⁴¹ The Court noted that usury laws determine whether a contract is void or valid when it is formed. Because usury laws apply only at inception, they cannot impair the obligations of duly established contracts, and do not violate the Contract Clause.

²³⁷ *Miller v Tiffany*, 68 US (1 Wall) 298, 310 (1863). The Court in *Miller* noted that it would not have permitted such a stipulation if it were made in bad faith. So long as “the form of the transaction is not adopted to disguise its real character,” the Court would uphold a stipulation of usury laws. *Id.*

²³⁸ See, for example, *Uniwest Mortgage Co v Dadecor Condominiums, Inc*, 877 F2d 431, 434–38 (5th Cir 1989) (holding that the law of the state chosen by the parties governed the contract at issue and that, since the parties had chosen Colorado law, the defense of usury was unavailable). See also Restatement (Second) of Conflict of Laws § 187 (1971).

²³⁹ *Beneficial National Bank v Anderson*, 539 US 1, 11 (2003).

²⁴⁰ US Const Art I, § 10, cl 1.

²⁴¹ See *Ogden*, 25 US (12 Wheat) at 348.

However, application of these laws after the contract's inception would violate the Contract Clause.²⁴²

For the Contract Clause to be applicable, a state law has to "operate[] as a substantial impairment of a contractual relationship."²⁴³ To find such an impairment, the court must find that (1) a contractual relationship existed; (2) "a change in law impairs that contractual relationship"; and (3) said impairment is "substantial."²⁴⁴ For purposes of the NBA, the change-in-law prong will be paramount to finding a violation of the Contract Clause. The idea that federal law pervades the interest rate provision of a contract may seem abstract, but the Supreme Court has suggested that it understands the NBA to operate in such a fashion.²⁴⁵ The Supreme Court has repeatedly described the NBA as federal law that governs the contracts into which national banks enter.²⁴⁶ As a result, federal law at the time of origination has declared the contract valid and nonusurious. To find that the law changed upon sale to a third party suggests that there is in fact a change in law. This potential change in law is likely void, as the Supreme Court has determined that "if a law should declare that contracts already entered into, and reserving the legal interest, should be usurious and void, either in the whole or in part, it would impair

²⁴² See *id.* at 326–27, 348.

²⁴³ *General Motors Corp v Romein*, 503 US 181, 186 (1992), quoting *Allied Structural Steel Co v Spannaus*, 438 US 234, 244 (1978).

²⁴⁴ *General Motors*, 503 US at 186.

²⁴⁵ See *Marquette*, 439 US at 308 (asserting that the interest rate a national bank can charge is "governed by federal law"); *Evans v National Bank of Savannah*, 251 US 108, 114 (1919) (holding that federal law "completely defines what constitutes the taking of usury by a national bank, referring to the state law only to determine the maximum permitted rate").

²⁴⁶ See *Barnett Bank*, 517 US at 32, quoting *Easton v Iowa*, 188 US 220, 229–30 (1903) ("[The] national banking system [is] normally 'independent, so far as powers conferred are concerned, of state legislation.'"); *Anderson National Bank v Lockett*, 321 US 233, 248 (1944) ("This Court has often pointed out that national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions."); *Griffith v Connecticut*, 218 US 563, 569–70 (1910), quoting *State v Hurlburt*, 82 Conn 232, 233–34 (1909) ("The exception from its operation of loans by national banks was merely a recognition of the legal effect, in excluding state legislation on the same subject, of the statutes of the United States which regulate their right to make such contracts."); *Waite v Dowley*, 94 US 257, 533 (1876) ("[W]here there exists a concurrent right of legislation in the States and in Congress, and the latter has exercised its power, there remains in the States no authority to legislate on the same matter.").

the obligation of the contract, and would be clearly unconstitutional.”²⁴⁷ Further, while the Contract Clause has fallen out of favor with courts,²⁴⁸ the Supreme Court has noted that although the state has the power to impair remedies, its police power is weaker when it destroys a contract.²⁴⁹ Finding support for the second prong of the Contract Clause analysis nullifies the potential for states to apply their usury laws to transferred contracts.

Though this analysis suggests the Contract Clause is implicated, courts may choose to avoid the constitutional question.²⁵⁰ Nevertheless, the potential implication of the Clause continues to support an interpretation that the NBA should continue to preempt after a transfer of an originally nonusurious loan.

Simplified, the above analysis provides two insights into whether preemption should continue after a sale to a third party. First, the Court has adopted a view on choice-of-law rules in the specific context of usury that should be followed: parties may contract at the time of origination for a law that applies regarding usury. In the context of an agreement with a national bank, the applicable law is governing federal law—the parties agree to 12 USC § 85 as a choice-of-law provision that applies the laws of the national bank’s location to any defense of usury. This choice of law should not change upon a transfer. Second, if federal law declares a contract nonusurious upon origination, any subsequent state law impairment of the contract may run afoul of the Contract Clause.²⁵¹

²⁴⁷ *Sturges v Crowninshield*, 17 US (4 Wheat) 122, 207 (1819). See also *Home Building & Loan Association v Blaisdell*, 290 US 398, 431–34 (1934) (“The obligations of a contract are impaired by a law which renders them invalid, or releases or extinguishes them.”).

²⁴⁸ See Jeffrey Omar Usman, *Constitutional Constraints on Retroactive Civil Legislation: The Hollow Promises of the Federal Constitution and Unrealized Potential of State Constitutions*, 14 Nev L J 63, 71–73 (2013), quoting Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U Ill L Rev 897, 941 (“[A]s interpreted, the Contract Clause does not have much bite.”).

²⁴⁹ *Blaisdell*, 290 US at 439:

Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them.

²⁵⁰ See *International Association of Machinists v Street*, 367 US 740, 749–50 (1961) (supporting the notion that when one interpretation has the potential to raise serious constitutional questions, the Court may choose another potential interpretation).

²⁵¹ See *Ogden*, 25 US (12 Wheat) at 326–27 (confirming the principle of *Sturges* that if usury laws “should be made to operate upon contracts already entered into, they would be unconstitutional and void”). See also *General Motors*, 503 US at 189 (citing *Sturges* for

Both of these analyses divert from the conflict-preemption analysis that the Court has traditionally conducted in NBA cases. Nevertheless, they provide further evidence that congressional intent likely supports preemption—these background principles all support preemption carrying forward absent a contrary indication from Congress.

C. A Transaction Cost Framework Shows That *Madden* Will Not Impact the Secondary Market for Loans and Will Harm Future Consumers

As shown above, preemption analysis does not provide a definitive answer to the question about loan transfers—the question whether a state law “significantly impairs” a national bank’s powers turns on factual characterization. While an interpretation of the NBA as federal law and the application of basic tenets of common law and of the Contract Clause suggest that the interest rate originally charged should continue posttransfer, no court that has addressed this issue has adopted that stance. This Section shows that the resolution of this issue does not affect the functioning of the market because “[i]t is always possible to modify by transactions on the market the initial legal delimitation of rights.”²⁵² And, because the states where national banks are located have essentially nonexistent usury laws,²⁵³ modifying contracts will not be prevented by the existing laws governing national banks. Adopting this view shows that creating barriers to transfer will harm consumers, not banks. To show how the view adopted in *Madden* can harm consumers, this Section first lays out a theoretical model for how banks navigate around the rule adopted in *Madden* by retaining a small portion of a loan upon sale. Next, this Section shows how banks will react if courts find such an approach unlawful.

1. Allowing state usury laws to apply after the sale of a loan will increase the cost of loans to consumers but will not stop national banks from selling these loans.

This Section explains the basic intuition that preventing the federal interest rate from following the loan will have the most-

the proposition that “[a] change in the remedies available under a contract, for example, may convert an agreement enforceable at law into a mere promise, thereby impairing the contract’s obligatory force”).

²⁵² Coase, 3 *J L & Econ* at 15 (cited in note 230).

²⁵³ See text accompanying note 51.

adverse consequences for consumers. For example, if preemption does not follow the full sale of a loan to a third party, a national bank could sell a 99 percent participation interest in the loan, allow the debt collector (as the bank's agent) to collect on the debt, and then engage in a swap transaction with the debt collector to swap the return on the last 1 percent of the debt still owned by the national bank.²⁵⁴ The national bank would still have an interest, albeit extremely minor, in the loan, but the national bank would bear no risk on that interest because of the swap, similar to *Krispin*.²⁵⁵ As this example shows, preventing preemption from following the debt will increase the cost of transferring the debt, but it is unlikely to have an impact on how banks conduct business.²⁵⁶

There are three scenarios in which the issue of preemption carrying forward emerges: (1) the national bank originates a loan with the intent to sell to a known buyer (a rent-a-charter scheme), (2) the national bank originates a loan with the intent to sell to an unknown buyer (securitization), and (3) the national bank originates a loan with the intent to hold the loan but will sell to an unknown buyer in the event of a default on the loan (a loan-to-hold scheme).

²⁵⁴ This would likely be permissible even under the Second Circuit's holding in *Madden*. The court suggested that so long as a national bank maintained an interest in the debt, preemption should continue to apply. See *Madden*, 786 F3d at 252–53, citing *Krispin*, 218 F3d at 924 (distinguishing the legality of applying preemption in *Krispin* from the illegality of applying preemption in the instant case because in *Krispin*, the national bank “retained an interest” in the debt).

²⁵⁵ *Krispin*, 218 F3d at 921–23. See also Part II.B.

²⁵⁶ Note that, throughout this Section, it is assumed that the consumer does not enter bankruptcy proceedings. Bankruptcy is a legitimate means by which consumers can reduce their debt burdens. See, for example, *Till v SCS Credit Corp*, 541 US 465, 470 (2004) (describing how filing for bankruptcy reduced the petitioners' debt burden). However, bankruptcy can be costly to consumers—it may reduce the amount of credit they are able to obtain in the future and come with a social stigma. See generally Kartik Athreya, *Shame as It Ever Was: Stigma and Personal Bankruptcy*, 90 *Econ Q* 1 (Spring 2004). Regardless, the ability to enter bankruptcy always lingers in the background but is beyond the scope of this Comment.

TABLE 1. NATIONAL BANK LOAN OPTIONS

Rent-a-Charter	Securitization	Loan-to-Hold
National bank originates a loan with the intent to sell to a known third party. This scheme is common when payday lenders use national banks to avoid state usury laws.	National bank originates a portfolio of loans with the intent to sell into a securitization vehicle. The true buyer of the debt is unknown at the time of origination, and the bank holds the risk if a securitization cannot be accomplished in the market.	National bank originates a loan for its balance sheet. The bank intends to service the loan and will likely continue to do so unless the debtor defaults, at which point the bank may sell the loan for risk or efficiency reasons.

In all three scenarios, a national bank would still be able to achieve the economic effects of a full sale, while maintaining preemption. As discussed above, this would involve partial sales and swaps contracts on top of those partial sales. In addition to the increased transaction costs of fully alienating the loan in a world in which preemption does not carry forward, the national bank may still be subject to potential liability under various laws, for example, the Fair Debt Collection Practices Act,²⁵⁷ if it must remain a lender of record to have preemption carry forward.

If national banks continue to be subject to potential liability when alienating their loans, they may increase the cost of their loans to account for this potential future cost. National banks, knowing *ex ante* that selling the full loan will be costly (in terms of increased transaction costs and potential liability), will account for these additional costs by charging consumers more for credit—the bank can create an identical economic situation regardless of the rule imposed by passing on its additional costs to consumers in the form of more-expensive credit. This will both make it more costly for most consumers to access credit and prevent the marginal consumer from obtaining credit. The marginal consumer seeking credit will tend to be the same person usury laws are

²⁵⁷ Pub L No 95-109, 91 Stat 874 (1977), codified at 15 USC §§ 1692–1692p.

meant to protect—a poorer individual with a weak or limited credit history.²⁵⁸

Even if these changes did not restrict consumers' access to credit, they would raise the cost of credit for consumers by increasing fees or interest rates.²⁵⁹ High interest rates may cause debtors to fall into a cycle of debt that is difficult to escape.²⁶⁰ Usury laws are one way that state governments work to prevent consumers from becoming trapped by this cycle of debt. Paradoxically, the application of state usury laws to transferred loans would harm consumers rather than protect them, which is the purpose of usury laws generally.²⁶¹ This insight has been confirmed empirically in other industries. For example, after a court ruled that a state could not discriminate between in-state and out-of-state sellers of wine, the price of wine at in-state stores declined dramatically.²⁶² Effectively, laws set up to isolate in-state consumers, and protect in-state businesses, from the force of the national market had the effect of increasing costs to consumers.²⁶³ Similarly, analysis of preempted state banking laws shows that, upon preemption, consumers' access to banking services increases.²⁶⁴

Additionally, preventing preemption from carrying forward does not serve the policy goals of state usury laws. National banks can still import lenient state usury laws into any state; they just would have to sell their loans more creatively. The policy of the NBA, in many ways, weakens the force and effect of state usury laws—reviving them via preventing preemption from carrying forward will not change the ability of banks to lend at rates higher

²⁵⁸ See Part I.D.

²⁵⁹ In the states where most national banks are located, namely, Delaware and South Dakota, there are effectively no usury limits, so the reality is that not allowing preemption to carry forward will not restrict a bank's ability to charge a consumer a higher interest rate up front to account for the potential of having to sell the defaulted loan at a lower price. See 5 Del Code Ann § 943 (allowing a bank to charge any "rate or rates as the agreement governing the [extension of credit] provides or as established in the manner provided in the agreement governing the [extension of credit]"); SD Cod Laws § 54-3-1.1 (establishing that "there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, limited liability companies, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement").

²⁶⁰ See Scott Horsley, *Payday Loans — and Endless Cycles of Debt — Targeted by Federal Watchdog* (NPR, Mar 26, 2015), online at <http://www.npr.org/2015/03/26/395421117/payday-loans-and-endless-cycles-of-debt-targeted-by-federal-watchdog> (visited Feb 27, 2016) (Perma archive unavailable).

²⁶¹ See Part I.D.

²⁶² Mason, Kulick, and Singer, 12 U Pa J Bus L at 800–01 (cited in note 105).

²⁶³ See *id.*

²⁶⁴ See *id.* at 794–97 (showing that after state restrictions on ATM fees were found to be preempted by the NBA access to ATMs increased).

than the state usury laws allow and will likely not protect consumers from these loans.

After *Madden*, this is no longer a theoretical discussion. Lending Club, a company that connects borrowers with nonbank lenders, has changed its practices in line with what the transaction cost framework suggests. Historically, loans originated by Lending Club were issued by banks, held for two days by the banks, and ultimately sold either to Lending Club or other nonbank lenders.²⁶⁵ Under the once nonusurious, always nonusurious framework, Lending Club's process is not problematic. In response to *Madden*, in February 2016, Lending Club revised its policy. Now, "the issuing bank maintains an on-going economic interest in all loans made after they are sold."²⁶⁶ The increased transaction costs this relationship adds to the process will ultimately be charged to the consumer—either in the form of higher interest rates or reduced credit. Lending Club's change concretizes the results suggested by the transaction cost analysis of the question of preemption continuing to apply after a sale—banks will find ways around it and consumers will be harmed.

2. Even if courts apply state usury laws to national bank-originated loans posttransfer, banks can mitigate their effects through contractual negotiation.

If the process of selling loans proposed above were struck down by courts,²⁶⁷ banks could change their contracts with consumers such that they would be allowed to charge a large default fee. Such a fee is unquestionably allowed under current preemption doctrine. The Supreme Court in *Smiley v Citibank (South Dakota), NA*²⁶⁸ upheld an OCC regulation that defined "interest" for the purposes of the 12 USC § 85 as including "any payment compensating a creditor or prospective creditor for an extension

²⁶⁵ See LendingClub Corp, *Form 10-K: Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended December 31, 2015* *9 (SEC, Feb 22, 2016), archived at <http://perma.cc/C3TV-PARF>.

²⁶⁶ *Lending Club Enhances Relationship with Issuing Bank* (PR Newswire, Feb 26, 2016), archived at <http://perma.cc/5PHA-E5CP>.

²⁶⁷ The courts in both *Madden* and *Krispin* did not define what an "interest" in a loan was for the purpose of preemption, though both concluded that if a national bank does have an interest in the loan, the NBA continues to preempt state law usury claims. If a court under the scenario presented in Part III.C.1 took a realist view—that is, that the bank does not have an interest in the loan economically although it is still technically the lender of record—then the court could strike down the practice of having banks retain small economic interests to allow preemption to continue postsale.

²⁶⁸ 517 US 735 (1996).

of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended.”²⁶⁹ Under this interpretation, fees that count as interest include late fees, annual fees, overdraft fees, and default fees.²⁷⁰ Additionally, these modifications could be made to existing contracts, as “lenders retain the right to change the contract at will” in most consumer credit contracts.²⁷¹

Once a consumer defaults, the bank can charge this default fee (and add it to the customer’s balance) before selling to a third party. Because a national bank, and not a third party, assesses the fee, NBA preemption applies to the portion of interest and fees that is charged before transferring the loan. That is, national banks could sell the loan for the same price as they do now by simply charging the future interest payments to the consumer up front in the form of a default fee and then selling the loan to a third party. This would harm a consumer who missed a payment for innocuous reasons, because the probability of the consumer being a true default borrower would already have been charged to his account.

3. The administrative uncertainty of allowing state usury laws to apply after a transfer is costly.

Lastly, returning to the Supreme Court’s logic in *Marquette*,²⁷² the uncertainty that could be created by not allowing the preemptive effect of the NBA to transfer may have deleterious effects on both consumers and banks. While it would be clear that NBA preemption would not continue, what would remain unclear is which state’s usury laws would apply to the loan after the sale—the state of the consumer, the state of the debt collector, or the state chosen in the original lending agreement? Per the discussion above, the common-law rules of contract suggest that the interest rate should transfer, but if they are not preempted, then each state’s choice-of-law rules would govern these issues independently. The costs of this uncertainty would likely also be factored into new loans going forward, increasing the costs for most

²⁶⁹ Id at 740, 747, quoting 61 Fed Reg 4689. This regulation is now codified at 12 CFR § 7.4001(a). See also *Smiley*, 517 US at 745–47 (holding that the OCC’s regulation defining interest expansively was a reasonable interpretation of the NBA).

²⁷⁰ 12 CFR § 7.4001(a).

²⁷¹ Bar-Gill and Warren, 157 U Pa L Rev at 13 (cited in note 98).

²⁷² See Part I.C.1.

consumers and leading to a reduction in credit available for the marginal consumer.

CONCLUSION

Unlike most federal laws, courts afford the NBA a presumption of preemption because of the unique history of the Act and because of Congress's fear that states would attempt to protect their banks at the expense of national banks. The Supreme Court continues to show deference to national banks when deciding whether state law applies to them. The current controversy—whether NBA preemption of state usury laws continues after sale of a loan to a third party—represents the latest battleground over NBA preemption. As shown above, applying state usury laws to third parties will likely impact the way a national bank does business, but preemption analysis is intensively fact driven. The complications of the analysis discussed above suggest that courts will not be well positioned to make these determinations. Because all courts agree that some harm will be generated, preemption is the best solution—precise line drawing here is too difficult, so convincing proof that this will significantly interfere with a national bank's business should be enough to warrant preemption carrying forward. Because of the factual basis of the preemption question, relying on analogies to other areas of law seems persuasive.

However, reliance on the principles of contract law, theories associated with federal incorporation of state laws, and an interpretation of the Contract Clause suggest that a loan, once non-usurious, does not become usurious as a result of a sale. Additionally, while first-order thinking may seem to suggest that holding state usury laws valid after the sale of a loan to a national bank will help consumers, analysis in a transaction cost framework reveals that just the opposite is true.

Usury laws have uniformly been enacted to protect consumers, though it remains an open question whether they truly protect consumers or instead harm them by reducing the availability of credit in the marketplace. Regardless, in this context, a finding that preemption does not continue upon sale of a loan would harm all consumers by increasing the cost of credit and likely cutting some marginal debtors out of the market. Creating a more complicated loan market that harms consumers is the wrong result, and when confronted with this issue courts should take second-order effects into account.