Banking and Finance Law Daily Wrap Up, TOP STORY—2nd Cir.: Debt collector can't claim national bank's interest rate preemption protection, (May 26, 2015)

Banking and Finance Law Daily Wrap Up

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By Richard A. Roth, J.D.

A debt collector that bought a national bank's charged-off credit card accounts could not rely on federal preemption to block a state-law usury suit, the U.S. Court of Appeals for the Second Circuit has decided. Since no national bank retained any interest in the accounts, the state interest rate limit did not interfere with a bank's ability to exercise powers granted by federal law, the court determined (*Madden v. Midland Funding, LLC*, May 22, 2015, Straub, C.).

Origin of the account. The complaining consumer originally opened a Bank of America credit card account, which later was transferred to FIA Card Services, N.A. Both of these are national banks. FIA sent the consumer an amendment to the card agreement that would, among other things, permit it to charge 27 percent annual interest, which was legal under the laws of Delaware, FIA's home state. (The consumer denied having received the notice of that amendment.)

When the consumer stopped making payments, she owed FIA about $5,000. FIA charged off the account and sold it to Midland Funding, LLC, a debt buyer. After the sale, neither FIA nor B of A had any interest in the account, the court observed.

Midland Funding's debt collection affiliate, Midland Credit Management, sent a collection letter to the consumer with a demand that included 27 percent interest. The consumer, however, lived in New York, which had a 25-percent interest rate limit.

Trial court results. The consumer filed a class action essentially claiming that Midland had violated the Fair Debt Collection Practices Act by attempting to collect interest at an illegal rate. Midland responded with its National Bank Act-based preemption argument. The NBA permits a national bank to charge interest at any rate permitted by its home state, regardless of where the borrower is located, and preempts any state usury law that would interfere with that authority (12 U.S.C. §85). Midland claimed it enjoyed the same protection because it was collecting a debt that had been originated by a national bank. Therefore, just as FIA, it could charge 27-percent interest.

The district court judge agreed with Midland that the consumer's usury claim was preempted. The preemption argument meant that a class action was inappropriate, the judge then said. Also, assuming Midland could prove that it owned the account and had successfully amended the account agreement, the consumer's FDCPA claims would fail. The consumer and Midland then agreed to use a procedural device to permit the judge to render a final judgment, and the consumer appealed.

Preemption. The appellate court began by observing that there are three kinds of preemption: Congress can explicitly preempt state laws, Congress can pass laws that are so comprehensive that there is no room left for state laws, or Congress can pass laws that conflict with state laws. In this case, conflict preemption was the issue.

It was true that NBA preemption extended to nonbanks in some situations, the court said. However, that only happened when preemption of a state law was needed to prevent significant interference with a national bank's exercise of its federally granted powers. A national bank's operating subsidiaries could benefit from preemption, as could a bank's agents, the court agreed. However, Midland, as a third-party debt buyer, was neither an operating subsidiary nor an agent. Midland was acting solely on its own behalf.

Neither of the Midland companies was a national bank, neither was a subsidiary or agent of a national bank, and neither was acting on behalf of a national bank, the appellate court said. The application of New York's usury law would not interfere with any national bank's exercise of powers granted by federal law. New York's usury law only would affect Midland's activities. That meant there is no reason for the state law to be preempted, the court decided.

Related decisions. Because the district court judge reached the wrong conclusion on the preemption argument, her decisions on two related issues—whether Midland had violated the Fair Debt Collection Practices Act and whether a class should be certified—had to be revisited, the appellate court determined. The decisions in favor of Midland on both of these issues were reversed.

The case is No. 14-2131-cv.

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Companies: Bank of America; FIA Card Services, N.A.; Midland Credit Management, Inc.; Midland Funding, LLC

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