STOPPING THIRD-PARTY DEBT BUYERS FROM USING NATIONAL BANK ACT PREEMPTION TO DODGE STATE USURY LAWS

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INTRODUCTION

Ashley Eneriz's mother struggled with debt her whole life.[1] She lived paycheck to paycheck, maxed out credit cards, took out high-interest auto loans, and was at times compelled to turn to payday lenders.[2] She aspired to go to school to become a grant writer, but her indebtedness was an insurmountable obstacle.[3] Instead, she took any job she could get to make ends meet for her and Ashley, often working as a school custodian.[4] At one point she had to sell her wedding ring at a pawn shop.[5] She would never escape her debt. In 2014, Ashley's mother drove her car off a cliff, falling 400 feet to her death.[6] Ashley, a financial journalist appearing in the Huffington Post and other publications, maintains "the most prevalent factor was money" on the cause of her mother's emotional distress.[7]

This is a sensational, but not an isolated, example. Millions suffer under the weight of unaffordable, crippling, high-interest debt every year.[8] The British Journal of Psychiatry found that debt increases the risk of suicidal thinking and the great recession resulted in an additional 10,000 "economic suicides" from 2008 to 2010.[9] High-interest debt is not an abstract or academic issue. It can have a devastating impact on the lives of low-income Americans.

Unfortunately, the interpretation of two federal statutes,[10] tacitly acknowledged by all but one federal circuit court,[11] is undermining state consumer protection efforts. This interpretation allows third-party debt buyers to avoid state interest rate caps.[12] This Note will demonstrate that these statutes are being interpreted incorrectly and will show why if courts adopt a different reading, state legislators could better protect

1. Ashley Eneriz, *What My Mom's Suicide Taught Me About Money*, CREDIT SESAME (Apr. 19, 2017), https://www.creditsesame.com/blog/debt/what-my-moms-suicide-taught-me-about-money/.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. Eneriz, *supra* note 1.

7. *Id.*; *see, e.g.*, STORIES BY ASHLEY ENERIZ: CONTENTLY, https://ashleyeneriz.contently.com (last visited Sept. 19, 2018).

8. *See, e.g.*, FED. RESERVE BANK OF N.Y., QUARTERLY REPORT ON HOUSEHOLD DEBT AND CREDIT 2017:Q3, at 3 (2017).

9. Aaron Reeves et al., *Economic Suicides in the Great Recession in Europe and North America*, BRIT. J. PSYCHIATRY 205, 246–47 (2014).

10. *See* 12 U.S.C. §§ 85, 1831d (2012).

11. *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 249–51 (2d Cir. 2015).

12. *See, e.g.*, Kirby M. Smith, Note, *Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales*, 83 U. CHI. L. REV. 1631, 1631 (2016).

consumers from dangerous high-interest debt.

In 2017, U.S. household debt reached an all-time high of $12.96 trillion.[13] Of this amount, 4.9% was delinquent, and most of that was more than 90 days delinquent.[14] In the third quarter of 2017 alone, 208,000 borrowers were reported to have filed for bankruptcy and 70,000 home foreclosures were initiated.[15] Consumer debt can have ruinous effects on an individual's financial well-being, but it can also prove detrimental for interpersonal relationships and psychological health.[16] Borrowing at high interest rates makes debt more expensive and makes it more difficult to pay off.[17] These factors exacerbate the problematic aspects of consumer debt and result in worse outcomes for individuals who rely on it.[18]

Usury is defined as "a premium or compensation paid or stipulated to be paid for the use of money borrowed or returned, beyond the rate of interest established by law."[19] The law of usury is one of the oldest tools consumer advocates have utilized to protect borrowers from the financial ruin which often accompanies high-interest debt.[20] Every one of the original thirteen colonies included a usury maximum in their founding charter.[21] The overwhelming majority of states still have such laws in effect.[22] Polling shows usury laws have broad support among members of both political parties.[23] However, Congress, along with the federal judiciary, have walked back much of the protection usury law once afforded consumers.[24] Federally insured depository institutions

13. *See* FED. RESERVE BANK OF N.Y., *supra* note 8.

14. *See id.* at 11.

15. *See id.* at 17.

16. *Debt and Suicide*, DEBT SUPPORT TR., http://www.debtsupporttrust.org.uk/debt-advice/debt-and-suicide (last visited Sept. 19, 2018).

17. *See* Lauren Saunders et al., *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default*, NAT'L CONSUMER LAW CTR., July 2016, at 1, 9 charts 2 & 3.

18. *See* Susanna Montezemolo & Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, CTR. FOR RESPONSIBLE LENDING, Mar. 2015, at 1, 5.

19. *Usury*, BLACK'S LAW DICTIONARY (2d ed. 1995).

20. *See Leviticus* 25:36–37 (King James).

21. CHARLES R. GEISST, LOAN SHARKS: THE BIRTH OF PREDATORY LENDING 4 (2017).

22. Colleen Honigsberg et al., *What Happens When Loans Become Legally Void? Evidence from a Natural Experiment*, J. LAW & ECON. (forthcoming) (manuscript at 8) (on file with SSRN), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215##.

23. *See* Memorandum from Lake Res. Partners and Chesapeake Beach Consulting to Interested Parties 2 (Jan. 22, 2015), http://www.responsiblelending.org/media-center/press-releases/Memo-CRL-Bipartisan-f-012215.pdf.

24. *See* 12 U.S.C. §§ 85, 1831d (2012); Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 310 (1978) (The U.S. Supreme Court, as an example of the federal judiciary interfering, held that a national bank was allowed to charge the higher interest rate

("banks")[25] and their affiliates are largely able to avoid compliance with usury laws thanks to the Supreme Court's interpretation of the National Bank Act (NBA) and the Depository Institutions Deregulation and Monetary Control Act (DIDMCA).[26] However, in recent years non-bank third-parties such as collection agencies and payday lenders have been relying on these same laws to avoid usury laws.[27] Legislation pending in Congress would solidify the ability of any third-party to ignore state usury laws so long as the debt was originated by a bank in a state with a favorable usury rate.[28]

Congress should reject this legislation and the judiciary outside the Second Circuit should adopt the Second Circuit's approach; third-parties should have to abide by state usury law, even when their notes are originated by a bank located in a state with a more favorable usury rate.[29]

This Note will show why third-party buyers of debt should not enjoy the benefit of federal preemption of state usury laws just because the loans originated with banks which do enjoy such preemption. This argument has four basic prongs discussed in parts II through V.

Part II will demonstrate that preemption of state usury laws does not extend to third-party debt buyers. Congress never intended for preemption to extend to third-parties. To the contrary, the intent of the NBA and DIDMCA was to incorporate state usury rates into federal lending law, not to subjugate them to the point of irrelevance.[30] Properly understood, federal preemption analysis leads to the conclusion that these statutes do not cover third-party debt buyers.

Part III will show high-interest rates are potentially harmful to consumers, especially marginal consumers at the bottom of the income scale. While there has been extensive debate on this point for centuries, legislatures of forty-six states and the District of Columbia have all seen

of the bank's resident state to out-of-state customers than was permitted by the customer resident state allowed.).

25. *See* 12 U.S.C. §§ 85, 1463(g), 1785(g), 1831d (2012). While there are substantial differences between the regulatory treatment of the different kinds of FDIC insured entities (savings associations, national banks, state banks, and credit unions), as it pertains to usury law, their compliance with state usury protections is largely identical. *See* Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 827 (1st Cir. 1992) (citing 96 CONG. REC. 6,907 (1980)) (finding the DIDMCA was drafted intentionally to mirror the effect of the NBA on state-chartered banks). To the extent there are nuances, they are beyond the scope of this note.

26. *See Marquette*, 439 U.S. at 310; Honigsberg et al., *supra* note 22, at 3.

27. *See* Honigsberg et al., *supra* note 22, at 11.

28. *See* Protecting Consumers' Access to Credit Act of 2017, H.R. 3299, 115th Cong. § 3.

29. *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 249–51 (2d Cir. 2015).

30. *See* 12 U.S.C. §§ 85, 1831d.

fit to protect consumers against high-interest rates in at least some circumstances.[31] Consumer protection has traditionally been an area where states hold broad discretion to use their police powers to enforce any rules they believe to be in the best interests of their citizens.[32] Federal courts and lawmakers should respect determinations states made in this context.

Part IV will explain that because third-party debt holders are not subject to the same degree of regulatory scrutiny as banks, there is a much greater risk they will engage in activity that harms consumers, such as charging unreasonably high rates of interest, insufficiently screening borrowers for ability to repay, and abusive collection tactics.[33]

Finally, Part V will show why the valid-when-made doctrine, which some have argued extends federal preemption to third-parties,[34] should not be relevant. This doctrine, while supported by some precedent,[35] is outdated, not designed for the transactions it is now being applied to, contrives the purpose of the NBA,[36] and is ill-suited to govern modern contracts.

For all these reasons third-parties should have to abide by state usury laws, even when they hold debt originated by banks located in states with permissive usury laws.

I. USURY LAW IN THE UNITED STATES

Although some view charging interest as sinful and prohibit the practice,[37] interest is legal in every state and is controlled by state usury statutes.[38] The judiciary has traditionally supported the general

31. PEW CHARITABLE TR., FROM PAYDAY TO SMALL INSTALLMENT LOANS: RISKS, OPPORTUNITIES, AND POLICY PROPOSALS FOR SUCCESSFUL MARKETS 12 (Aug. 11, 2016), https://www.pewtrusts.org/-/media/assets/2016/08/from_payday_to_small_installment_loans.pdf.

32. *See, e.g.*, Commonwealth v. Alger, 61 Mass. 53, 85 (1851).

33. *See* RICHARD SCOTT CARNELL ET AL., THE LAW OF BANKING AND FINANCIAL INSTITUTIONS 380 (4th ed. 2009); Lauren Goldberg, *Dealing in Debt: The High-Stakes World of Debt Collection After FDCPA*, 79 S. CAL L. REV. 711, 729 (2006).

34. Charles M. Horn & Melissa R. H. Hall, *The Curious Case of Madden v. Midland Funding and the Survival of the Valid-When-Made Doctrine*, 21 N.C. BANKING INST. 1, 14 (2017).

35. *See, e.g.*, Nichols v. Fearson, 32 U.S. 103, 109 (1833); Gaither v. Farmers & Mechs. Bank, 26 U.S. 37, 43 (1828).

36. *Compare Nichols*, 32 U.S. at 103, *with* 12 U.S.C. § 85 (2012).

37. Holly E. Robbins, *Soul Searching and Profit Seeking: Reconciling the Competing Goals of Islamic Finance*, 88 TEX. L. REV. 1125, 1127–28 (2010).

38. CARNELL ET AL., *supra* note 33, at 336.

legitimacy of usury laws.[39] Although usury is as old as the union itself,[40] its form, application, and enforcement have fluctuated over time.[41] Congress left it to states to determine the appropriate rate of usury,[42] so there are hardly any two states with an identical scheme.[43]

A. Various State Usury Law Standards

New York has a relatively complex usury scheme of varying rates, penalties, and exceptions. The maximum lawful rate of interest is sixteen percent.[44] Lenders found to have charged greater than sixteen percent may have to forfeit future payments, interest, and principal under the usurious agreement.[45] There is a separate criminal usury rate for knowingly charging interest greater than twenty-five percent.[46] Violating the criminal limit is a class E felony punishable by up to four years' probation.[47] Usury laws are intended primarily to protect consumers, not to stifle commercial investment, so New York excepts loans over $2.5 million and those over $250,000 not secured by the principal residence of the borrower from the civil limit.[48]

Colorado enforces a twelve percent limit on consumer loans,[49] and excepts institutions specifically **"**supervised**"** by a state or federal agency.[50] A more encompassing limit of forty-five percent applies to all loans regardless of whether they fall into the class of "consumer loans."[51] Knowingly collecting interest at or above this limit is considered a class

39. "No court would declare a usury law unconstitutional, even if every member of it believed that Jeremy Bentham had said the last word on that subject, and had shown for all time that such laws did more harm than good." Otis v. Parker, 187 U.S. 606, 609 (1903); "You are one of the most contemptible usurers in your unspeakable business. . . . The poor people must be protected from such sharks as you . . . . Men of your type are a curse to the community, and the money they gain is blood money." Daniel H. Tolman, *'Loan Shark,' Dies*, N.Y. TIMES, Feb. 14, 1918, at 11 (quoting a trial judge at the sentencing of infamous salary buyer Daniel H. Tolman).

40. *See* GEISST, s*upra* note 21, at 8–9.

41. *See, e.g.*, *id.* at 9 ("Indiana abolished its usury ceiling in the mid-1830s, but reinstated it four years later. Wisconsin ended its ceiling in 1849, but reinstated it after only a few months. In both cases, the public clamored for the protections to be reinstated.").

42. *See* 12 U.S.C. § 85 (2012).

43. *Compare* N.Y. BANKING LAW § 14-a(1) (McKinney 2013), *with* COLO. REV. STAT. § 5-2-201(1) (2017), *and* OHIO REV. CODE ANN. § 1343.01(A) (West 2016).

44. BANKING § 14-a(1).

45. N.Y. GEN. OBLIG. LAW § 5-511(2) (McKinney 2012).

46. N.Y. PENAL LAW § 190.40 (McKinney 2010).

47. N.Y. PENAL LAW § 70.00(2)(e) (McKinney 2009).

48. N.Y. GEN. OBLIG. LAW § 5-501(6)(a)–(b) (McKinney 2012).

49. Colo. Rev. Stat. § 5-2-201(1) (2017).

50. *Id.* § 5-2-201(2).

51. COLO. REV. STAT. § 5-12-103(1) (2017).

six felony.[52]

In Ohio, the limit on consumer loans is eight percent.[53] Ohio's legislature created several exceptions, including loans over $100,000,[54] loans made by specifically regulated lenders,[55] loans secured by residential real estate,[56] and loans made for business purposes.[57]

These examples are indicative of the wide range of different policies states have enacted to reflect their various viewpoints about the degree to which consumers need protection from the potential perils of high-interest lending. A common theme found in most statutes is a more accommodating policy for commercial and high dollar loans.[58] Borrowers at this end of the market are presumably in a better position to negotiate a competitive price, not to be taken advantage of due to unequal knowledge of available products, and to possess the requisite degree of sophistication to accurately gauge their own capacity to repay their creditors. Elected state officials weigh the sensibilities of their citizens along with their impressions of the costs and benefits associated with usury laws when making these determinations.

A small minority of states have taken a very permissive approach, allowing any rate of interest to be lawful and enforceable. In Delaware, banks can charge any rate of interest agreed to in writing.[59] Utah has no effective usury law in place for any loan agreement.[60] South Dakota has also chosen not to limit the amount of interest which may lawfully be charged.[61]

Despite most states' efforts to protect consumers from high-interest debt, while also balancing legitimate concerns about the degree to which

52. COLO. REV. STAT. § 18-15-104(1) (2017).
53. OHIO REV. CODE ANN. § 1343.01(A) (West 2016).
54. *Id.* § 1343.01(B)(1).
55. *Id.* § 1343.01(B)(2).
56. *Id.* § 1343.01(B)(3).
57. *Id.* § 1343.01(B)(6)(a).
58. *See, e.g.*, N.Y. BANKING LAW § 340 (McKinney 2012) (excusing loans over $250,000 from the civil usury limit).
59. DEL. CODE ANN. tit. 5, § 943 (2001) ("A bank may charge and collect periodic interest under a revolving credit plan on outstanding unpaid indebtedness in the borrower's account under the plan at such daily, weekly, monthly, annual or other periodic percentage rate or rates as the agreement governing the plan provides . . . .").
60. UTAH CODE ANN. § 15-1-1(1) (LexisNexis 2013) ("The parties to a lawful contract may agree upon any rate of interest for the loan or forbearance of any money, goods, or chose in action that is the subject of their contract.").
61. S.D. CODIFIED LAWS § 54-3-1.1 (2004) ("[T]here 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.").

usury laws can stifle commercial activity, two federal statutes are being interpreted to allow debt holders to utilize laws in the few most permissive jurisdictions to collect high interest rates.[62]

B. How Usury Laws are Avoided by Third-Parties Using Federal Banking Law

The NBA and DIDMCA have been interpreted such as to allow banks to "export" the usury law of their home state.[63] In 1978, the Supreme Court first determined that banks can rely on the usury law (or lack thereof) of the state where they are chartered in charging interest to customers regardless of where the consumer resides.[64] But consumer debt is routinely sold to collection agencies and other non-bank entities in different states.[65] Because many loans are originated by banks in states with very weak or non-existent usury laws,[66] and because few courts have ever held the practice violates any law,[67] third parties can continue to charge usurious rates of interest so long as the notes were originated lawfully by a bank.[68] Only the Second Circuit has determined that these third-party debt buyers cannot continue to charge consumers rates which would be usurious had they themselves originated them.[69]

Take a hypothetical consumer in Alabama, a state with a usury rate of eight percent.[70] If a consumer receives a loan or makes a purchase on a credit card issued by a bank located in Utah, a state with no usury maximum,[71] at a rate of thirty-six percent, Alabama's usury law would do nothing to protect the consumer, no matter how much interest they eventually pay on their balance. Furthermore, if the Utah bank sells the note (or the right to collect on the credit card balance) to a debt buyer located in Alabama, then Alabama's usury law would still be inapplicable to the transaction. The fact that both the entity collecting interest payments at quadruple the lawful rate and the consumer paying them are now both located in Alabama means nothing for Alabama's ability to enforce its own usury laws. This is an absurd result and courts should find federal preemption of state usury laws inapplicable to third-party debt

62. *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 314 (1978).
63. *See id.* at 312.
64. *Id.* at 318.
65. *See* Horn & Hall, *supra* note 34, at 22.
66. *See* Zachary Adams Mason, *Online Loans Across State Lines: Protecting Peer-to-Peer Lending Through the Exportation Doctrine*, 105 GEO. L.J. 217, 220–26 (2016).
67. *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 249–51 (2d Cir. 2015).
68. *See Marquette*, 439 U.S. at 310.
69. *See Madden*, 786 F.3d at 249–51.
70. ALA. CODE § 8-8-1 (2017).
71. UTAH CODE ANN. § 15-1-1(1) (LexisNexis 2013).

buyers unless they are a subsidiary of or acting as an agent on behalf of the bank who makes the loan.

C. Peer-to-Peer Lending Platforms Take Advantage of States with Lax Usury Laws

Another increasingly prevalent example is the business model of so-called "peer-to-peer lending" companies ("platforms") which have become a popular source of consumer credit in recent years.[72] Firms operating these platforms market themselves as coordinating opportunities for individuals to "invest in personal loans."[73] Their business model is adroitly designed to take advantage of federal preemption of state usury laws.[74] Platforms attract borrowers in need of credit and investors interested in earning returns on consumer credit.[75] Once the platforms have matched borrowers and investors whose respective needs create the potential for a mutually beneficial transaction, WebBank, a Utah-chartered state bank, issues a loan to the borrower.[76] The platforms will then purchase the note from WebBank at face value.[77] Investors simultaneously make a loan to the platform and the platform agrees to pay them back, contingent upon the borrower paying the platform back on the note.[78] Fees charged along the way allow the platform to turn a profit and the use of investor funds insulates them from default risk.[79]

WebBank's role in the transaction is a thinly-veiled vehicle for forum shopping. WebBank's Utah charter allows firms utilizing this model to avoid compliance with usury laws in the states where they operate.[80] While a certain degree of forum shopping is permissible in commercial law,[81] it does not belong in consumer protection. Adopting a tougher stance on usury would limit over-borrowing for high risk and targeted customers.

72. *See* Prableen Bajpai, *The Rise of Peer-To-Peer (P2P) Lending*, NASDAQ (Sept. 27, 2016), http://www.nasdaq.com/article/the-rise-of-peertopeer-p2p-lending-cm685513.

73. *Invest*, PROSPER, https://www.prosper.com/invest (last visited Sept. 19, 2018).

74. *See, e.g.*, Mason, *supra* note 66.

75. *Id.* at 220.

76. *Id.* at 220–24 (WebBank is the bank used by the duopolistic peer to peer lending firms LendingClub Corp. and Prosper Funding, LLC.).

77. *Id.* at 225.

78. *Id.*

79. *See* Mason, *supra* note 66, at 222, 226.

80. Smith, *supra* note 12.

81. *See, e.g.*, Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 966 (1995) (noting about half of the companies listed in the S&P 500 Index are incorporated in Delaware to take advantage of favorable tax laws and court system).

The current treatment of federal preemption outside the Second Circuit allows non-bank firms such as payday lenders, third-party debt collectors, and peer-to-peer lending platforms to select which states' usury rate they find most appealing.[82] Allowing firms to use this simple end run around state law is a form-over-substance approach to consumer financial protection. It degrades states' ability to protect consumers from predatory business practices, violates states' rightful police powers, and it is contrary to the purpose of the NBA and DIDMCA.

II. Federal Preemption of State Usury Laws

The history of federal usury preemption is useful to understand the argument for its application to notes held by third-party debt buyers and to understand the flaws of this argument.

A. Timeline of Federal Usury Preemption

McCulloch v. Maryland is famous for its nation-shaping interpretation of the supremacy clause: "The government of the United States, then, though limited in its powers, is supreme; and its laws, when made in pursuance of the constitution, form the supreme law of the land, 'any thing in the constitution or laws of any State to the contrary notwithstanding.'"[83] But *McCulloch* also cemented Congress's role in regulating banks.[84] An important outcome was the determination that the authority to charter banks was within the powers of Congress.[85] From the date of this decision on, its authority to charter, insure, and otherwise regulate banks has been ubiquitously acknowledged.[86]

Congress's most significant exercise of this power was in reforming broad aspects of the nation's banking system when it passed the NBA in 1864.[87] Express preemption of state usury laws for nationally-chartered banks was included in this sweeping reform.[88] It established that for nationally chartered banks, the usury rate would be the greater of:

> interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is

82. *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 314 (1978).
83. 17 U.S. 316, 406 (1819) (citing U.S. Const. art. VI, § 2).
84. *Id.* at 424–25.
85. *Id.* at 425.
86. *See, e.g.*, Cuomo v. Clearing House Ass'n, 557 U.S 519, 553 (2009).
87. National Bank Act, ch. 106, 13 Stat. 99 (1864) (codified as amended in scattered sections of 12 U.S.C.).
88. 12 U.S.C. § 85 (2012).

located . . . .[89]

Congress also created an exclusive cause of action for usury claims against nationally-chartered banks.[90]

In 1874, the Supreme Court determined that even if states try to restrict their own chartered banks to a lower usury rate, the maximum lending rate allowed for national banks in the state would be the rate allowed for any lender.[91] The Court clarified that the purpose of the NBA was to give national banks a firm foothold in the several states and to isolate them from unfair competition from state institutions.[92]

Over a century later, the Court further expanded the reach of the NBA.[93] It held that for a national bank, making a loan to a consumer outside its home state, the bank could export its home state's usury law,[94] notwithstanding the consumer's home state enforcing a usury rate lower than the interest rate the consumer was charged.[95] After *Marquette*, notes issued by national, as opposed to state-chartered, banks rose at a furious pace.[96]

Even less surprisingly, major banks' consumer credit wings began relocating from their original home states in favor of more lenient usury jurisdictions.[97] Citibank and Chase, both New York-based national banks, relocated their credit card lending operations to South Dakota and Delaware respectively.[98]

To account for the incredible advantage *Marquette* afforded nationally-chartered banks, Congress included a parallel benefit for state-chartered banks in the DIDMCA.[99] The language in the Act modified the Federal Deposit Insurance Act to extend usury preemption, then available to nationally-chartered banks, to all depository institutions covered by the

89. *Id.*
90. 12 U.S.C. § 86 (2012).
91. Tiffany v. Nat'l Bank of Mo., 85 U.S. 409, 412 (1874).
92. *Id.*
93. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 310 (1978).
94. *Id.*
95. *See* MINN. STAT. § 48.185 (2016).
96. *Commercial Banks—Historical Statistics on Banking: Assets*, FDIC, tbl.CB09, https://www5.fdic.gov/hsob/HSOBRpt.asp (last visited Sept. 20, 2018).
97. GEISST, *supra* note 21, at 234.
98. *Id.* Today, Wells Fargo, Bank of America, and Discover Bank are all also incorporated in Delaware. *See In re* Wells Fargo & Co. S'holder Derivative Litig., 282 F. Supp. 3d 1074, 1110 (N.D. Cal. 2017); *see also* Allstate Indem. Co. v. Collura, No. CV. 15-5047 (JS) (AKT), 2017 U.S. Dist. LEXIS 18057, at *28 (E.D.N.Y. Feb. 7, 2017); *In re* Discover Fin. Servs. Derivative Litig., No. 12 C 6436, 2015 U.S. Dist. LEXIS 35423, at *3 (N.D. Ill. 2015).
99. 12 U.S.C. § 1831d(a) (2012).

Federal Deposit Insurance Corporation (FDIC).[100]

In 2007, the Court provided another boon to banks when it determined the protections they are afforded from state regulations under the NBA extend to their "operating subsidiaries."[101] The Court found state laws restricting national banks' operating subsidiaries ability to engage in real estate lending was in conflict with a federal statute allowing national banks to engage in that business.[102] This interpretation echoed the Office of the Comptroller of Currency's (OCC) opinion of the extent of federal preemption.[103] While the issue in *Watters* was not relating to usury,[104] proponents of banks' ability to pass on their federal preemption privileges to third-parties have relied on it as providing additional support to their argument.[105] In fact, the most expansive interpretations of *Watters* have gone as far as holding that the decision allows national banks to extend their federal preemption of state usury limits to any firm acting as their agent.[106]

The Second Circuit made some waves[107] when it took a step to corral impunity from state usury laws in the secondary note market.[108] Plaintiffs, New York consumers, appealed a verdict in favor of a lender who was charging them interest on credit card debt at a rate which far exceeded the sixteen percent statutory limit.[109] The Second Circuit rejected the defendant's contention that because the interest being charged was on loans originated by a bank in a state with a usury limit making the loan allowable, it was necessarily lawful as to this New York entity charging the New York consumer.[110] They agreed with plaintiffs

100. *Id.*

101. Watters v. Wachovia Bank, N.A., 550 U.S. 1, 19 (2007), *superseded by statute*, Dodd-Frank Act, Pub. L. No. 111-203, §§ 1044(a), 1045, 1047(a), 124 Stat. 1376, 2014, 2017–18 (2010).

102. *Id.* (citing Wells Fargo Bank, N.A. v. Boutris, 419 F.3d 949, 960 (9th Cir. 2005)).

103. 12 C.F.R. § 7.4006 (2002), *removed and reserved*, 76 Fed. Reg. 43,549, 43,565 (July 21, 2011).

104. *See* 550 U.S. at 7.

105. *See, e.g.*, Smith, *supra* note 12, at 1640.

106. *See* Pac. Capital Bank, N.A. v. Connecticut, 542 F.3d 341, 352–53 (2d Cir. 2008) (first quoting *Watters*, 550 U.S. at 18; and then quoting 12 U.S.C. § 24 (2012)), *superseded by statute*, Dodd-Frank Act §§ 1044(a), 1045, 1047(a).

107. *See* Michael C. Tomkies & Susan Manship Seaman, *Stop the Madden Madness*, LAW360 (Nov. 25, 2015, 11:05 AM), https://www.law360.com/articles/731392/stop-the-madden-madness.

108. *See* Madden v. Midland Funding, LLC, 786 F.3d 246, 249 (2d Cir. 2015).

109. *See id.* at 248–49 (first citing 15 U.S.C. §§ 1692e, 1692f (2012); then citing N.Y. GEN. BUS. LAW § 349 (McKinney 2012); then citing N.Y. GEN. OBLIG. LAW § 5-501 (McKinney 2012); and then citing N.Y. PENAL LAW § 190.40 (McKinney 2010)); *see also* N.Y. BANKING LAW § 14-a (McKinney 2013).

110. *Madden*, 786 F.3d at 250.

that third-party debt buyers were not the intended beneficiaries of federal preemption of state usury limits under the NBA.[111]

Reaction to the ruling was immediate. Some non-banks within the Second Circuit's jurisdiction aligned themselves more closely with regulated bank entities.[112] Others restructured their business practices so that banks in states with favorable usury limits have an interest in the transactions they are conducting.[113] These are positive developments in that they bring debt holders closer to the same regulators who supervise bank activities.[114] Less encouraging was legislation introduced in Congress which would effectively overturn *Madden* and allow any firm to use banks in states with favorable usury laws to charge consumers any amount of interest, leaving the states helpless to prevent it.[115]

B. Federal Preemption Should Not Extend to Banks' Unaffiliated Assignees

Because of the Supremacy Clause, Congress has the authority to pass laws which displace contrary state law.[116] But in the context of state usury laws' application to third-party buyers of bank-originated consumer debt, it has declined to do so. Some contend that this application is preempted because the state laws are in conflict with the NBA and DIDMCA.[117] This is incorrect. Federal preemption does not extend to third-party buyers of debt if they are neither affiliated with nor acting as an agent of a bank.[118]

Federal preemption of state law takes one of three forms: express preemption, field preemption, or conflict preemption.[119] Conflict preemption is further divided into two types concisely characterized as where either "compliance with both federal and state regulations is a physical impossibility"[120] or where the state law "stands as an obstacle to

111. *Id*. at 251 (citing Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 33 (1996)).
112. *See* Mason, *supra* note 66, at 242–43.
113. *Id.*
114. *See id.*
115. Protecting Consumers' Access to Credit Act of 2017, H.R. 3299, 115th Cong. § 3.
116. McCulloch v. Maryland, 17 U.S. 316, 406 (1819) (citing U.S. CONST. art. VI, § 2).
117. Brief for United States as Amicus Curiae Supporting Petitioner at 9, Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015) (No. 15-610).
118. *Madden*, 786 F.3d at 249–51.
119. Arizona v. United States, 567 U.S. 387, 399 (2012) (first citing U.S. Chamber of Commerce v. Whiting, 563 U.S. 582, 592 (2011); then citing Gade v. Nat'l Solid Waste Mgmt. Ass'n, 505 U.S. 88, 115 (1992); and then citing Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372 (2000)).
120. Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142–43 (1963) (citing Union Bridge Co. v. United States, 204 U.S. 364, 399–401 (1907)).

the accomplishment and execution of the full purposes and objectives of Congress."[121] With respect to banks, state law can control so long as it "does not prevent or significantly interfere" with their powers under the NBA.[122] Those powers have been specifically delineated by Congress.[123] While those powers are not exhaustive, "the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated. The exercise of the Comptroller's discretion, however, must be kept within reasonable bounds."[124]

In *Barnett Bank*, the Supreme Court found that banks had the authority to sell insurance despite contrary state laws.[125] "[N]ormally Congress would not want States to forbid, or to impair significantly, the exercise of a power that Congress explicitly granted."[126] But Justice Stephen Breyer, writing for the majority, qualified this statement: "To say this is not to deprive States of the power to regulate national banks, where (unlike here) doing so does not prevent or significantly interfere with the national bank's exercise of its powers."[127] This qualifier has become the test courts use to determine whether a state law is in conflict with the federal banking law.

Forcing third-party assignees of debt from national banks to comport with otherwise applicable state usury law does not significantly frustrate national banks' inherent or incidental powers under the NBA.[128] The exportation of favorable state law is not necessary to carry on the business of banking. It is not among their enumerated powers,[129] and the experience of the Second Circuit since *Madden* has evidenced no great upheaval in the financial world.[130] It is accurate to say that forcing third-parties to comply with state interest rate limits would interfere with national bank powers in that it would marginally affect the prices they are able to command when selling debt on the secondary market. But this alone is not a frustration of bank powers.

Thinking about the distinctions between the business of the

121. Hines v. Davidowitz, 312 U.S. 52, 67 (1941).
122. Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 33 (1996) (citing Anderson Nat'l Bank v. Luckett, 321 U.S. 233, 248 (1944)).
123. *See* 12 U.S.C. § 24 (2012).
124. Nationsbank of N.C., N.A. v. Variable Annuity Life Ins., 513 U.S. 251, 258 n.2 (1995).
125. 517 U.S. at 37.
126. *Id.* at 33.
127. *Id.* (citing Anderson Nat'l Bank v. Luckett, 321 U.S. 233, 248 (1944)).
128. *See* 12 U.S.C. § 24.
129. *See id.*
130. *See* Honigsberg et al., *supra* note 22, at 4.

defendants in *Barnett Bank* and that of third-party debt buyers illustrates why that standard should not lead to the same conclusion. In *Barnett Bank*, a case contentious enough that the Supreme Court granted certiorari to resolve, the bank itself was permitted to engage in an activity it was explicitly authorized by the NBA to do over state objections.[131] Contrast third-party debt buyers who are engaging in an activity which state law prohibits, relying on a law which does not even apply to them for their justification.[132] Under federal law one of the powers banks are authorized to engage in is selling notes.[133] But there is no mention of what the buyers of those notes are allowed to do with them.[134] Although propping up the value of notes on the secondary market by allowing third parties to charge any interest rate would certainly benefit banks, suggesting that not allowing banks to reap as high a price on these notes is a significant interference with their powers under the NBA and DIDMCA is tenuous, at best.

In a dispute about whether state powers to subpoena bank records were preempted by the NBA, the Court held, over the objection of the OCC, that New York could enforce the state's criminal laws.[135] Per the NBA and the OCC, the bank's federal regulator had exclusive "visitorial" authority over bank operations.[136] This came into conflict with the New York Attorney General's desire to examine private client records in pursuit of a criminal conviction.[137] Holding for the state, the Court found that states retained the authority to regulate banks in areas such as "contracts, debt collection, acquisition and transfer of property, and taxation, zoning, criminal, and tort law."[138] Application of the state law in these areas did not frustrate the business of banking such as to allow preemption.[139] The dissent went even further, applying the longstanding principle of preemption that "the historic police powers of the States [are] not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress . . . ."[140]

131. 517 U.S. at 28 (quoting 12 U.S.C. § 92 (2012)).
132. *See* 12 U.S.C. § 37 (2012).
133. *See* 12 U.S.C. § 24.
134. *See id.*
135. Cuomo v. Clearing House Ass'n, 557 U.S. 519, 536 (2009).
136. *Id.* at 524–25 (first quoting 12 U.S.C. § 484(a) (2012); and then quoting 12 C.F.R. § 7.4000 (2009) (amended 2011)).
137. *Id.* at 522–23.
138. *Id.* at 531 (quoting Bank Activities and Operations, 69 Fed. Reg. 1895, 1896 (Jan. 13, 2004)).
139. *See id.* at 531–32 (quoting Bank Activities and Operations, 69 Fed. Reg. at 1896).
140. *Cuomo*, 557 U.S. at 554 (Thomas, J., dissenting) (alteration in original) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

Preemption of state usury laws implicates the common law contract law of assignments, debt collection, transfers of property, and criminal laws. Just like the ability to enforce substantive criminal procedure was within the state's authority in the absence of a clear statutory basis for its preemption,[141] enforcement of state usury law on third-parties should remain within the state's authority. As in *Cuomo*, third-party debt buyers cannot show that it was the manifest purpose of Congress to supplant usury law in most states.[142]

In a situation analogous to that of third-party debt buyers seeking federal preemption, the Second Circuit held against a third-party attempting to claim it inherited federal preemption of a state regulation from a national bank with which it was doing business.[143] A bank issued prepaid debit cards to a Connecticut company which owned and managed real estate ("SPGGC"), who would then sell the cards to consumers.[144] The bank would profit by keeping interchange fees generated from various retailers who accepted the cards.[145] SPGGC would profit by charging certain fees to consumers both at activation and upon one of several contingencies such as inactivity or the need for a replacement card.[146] The issue in *SPGGC* arose out of a Connecticut law which banned the use of some of the fees which SPGGC used to make its end of the agreement profitable.[147] SPGGC argued that because it was associated with a bank, it was entitled NBA preemption and therefore immune from regulatory oversight from the State of Connecticut.[148]

The Second Circuit rejected SPGGC's defense.[149] The Court emphasized the difference between preemption by association, which the plaintiff argued should apply, and preemption by virtue of subsidiary status, which was the basis for preemption in *Watters.*[150] "[I]t would be a mistake to read *Watters* so broadly as to obscure the unique role assigned to operating subsidiaries in the context of national banking regulation."[151] The dispositive inquiry for the court was whether the state regulation was a limit on the bank's incidental powers or a control on the third-party.[152]

141. *Id.*
142. *See id.*
143. SPGGC, LLC v. Blumenthal, 505 F.3d 183, 196–97 (2d Cir. 2007).
144. *Id.* at 186.
145. *Id.* at 187.
146. *Id.*
147. *Id.* (citing CONN. GEN. STAT. §§ 3-65c, 42-460 (2007)).
148. *SPGGC*, 505 F.3d at 189–90.
149. *Id.* at 196–97.
150. *Id.* at 189–90 (citing Watters v. Wachovia Bank, N.A. 550 U.S. 1, 19 (2007)).
151. *Id.* at 190.
152. *Id.* at 191.

The court concluded that as a third-party, SPGGC enjoyed no special status under the NBA and that the regulation was only a control on the third party.[153]

C. Third-Party Preemption Contrives the Purpose of the NBA

It is important when determining whether federal preemption should apply to third-party debt buyers to first consider the purposes of the NBA. It takes great imagination to contend that the intent of Congress was to nullify the usury laws of all but a small handful of the most permissive states. Had Congress so intended, they would have been well within their authority to create a unified national usury scheme.[154] This is exactly what they have done for military personnel.[155] The stated objective of the NBA was to create a strong national banking system and to protect banks from potentially anti-competitive state legislation.[156] And courts have interpreted Congress's adoption of the exact language in the DIDMCA as expressing a desire to adopt its aims as well.[157] That a small handful of jurisdictions exists, where all debt holders, banks and non-banks alike, can funnel their transactions through to evade the usury laws in the states where they operate actually smacks of anti-competitiveness. In the context of a law which greatly expanded national control over banking regulations, it should be considered indicative of Congressional intent that they affirmed the role of the states in determining which usury laws ought to apply in their jurisdiction. In this one area, Congress knew that state legislators would be the best bodies to determine the maximum rate their citizens could afford and that their collective consciousness could tolerate. An interpretation which would render the laws of forty-six states a nullity must be a far cry from what Congress intended.

When evaluating the role of third-party debt buyers in the context of the secondary credit market, courts should find, as the Second Circuit did in *SPGGC*, that firms who purchase bank debt and are neither subsidiaries nor acting as agents of banks, should not be afforded the same authority under the NBA and DIDMCA.[158] These potentially dangerous powers

153. *SPGGC*, 505 F.3d at 190.

154. *See* Wickard v. Filburn, 317 U.S. 111, 123–24 (1942).

155. There is a thirty-six percent cap on the amount any lender may charge active duty military personnel or their immediate family members. 10 U.S.C. § 987(a)–(b) (2012).

156. Tiffany v. Nat'l Bank of Mo., 85 U.S. 409, 413 (1874).

157. *See* 12 U.S.C. § 1831d (2012). Drafters of the DIDMCA intentionally borrowed language from the NBA in order to grant state-chartered banks the benefits national banks enjoyed with regard to usury under the NBA, and in order to further the goal of establishing competitive equality between state and federally chartered depository institutions. Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 826 (1st Cir. 1992).

158. *See* 505 F.3d at 190.

should be reserved for regulated institutions such as banks themselves.

III. THE HARMS OF OVEREXTENSION OF CREDIT AND HIGH-INTEREST LENDING

Debt has become an increasing burden on Americans' financial well-being. Between 1980 and 2011 consumer debt grew sixty percent faster than average income.[159] Debt-related stress has been linked to health problems including headaches, backaches, ulcers, increased blood pressure, depression and anxiety.[160] High levels of debt have also been found to correlate with decreased job performance and increased absenteeism.[161] The Center for Responsible Lending endorses a bill which would set a national usury rate of thirty-six percent[162] and condemns loans above this rate as being "structured to create a long-term debt trap that drains consumers' bank accounts and causes significant financial harm, including delinquency and default, overdraft and non-sufficient funds fees, increased difficulty paying mortgages, rent, and other bills, loss of checking accounts, and bankruptcy."[163]

One of the most harmful forms of consumer credit, payday loans, have been characterized as unaffordable for most borrowers, leading to repeat borrowing, and promoting indebtedness that is far longer than advertised.[164] High-interest rates tend to be charged to marginal borrowers and can trap vulnerable individuals into a cycle of borrowing.[165] There is the potential that firms will abuse borrowers, many of whom have very limited financial literacy.[166] Some thirty million Americans every year receive calls from collection agencies seeking to receive payments on defaulted debt.[167]

159. Neil L. Sobol, *Protecting Consumers from Zombie-Debt Collectors*, 44 N.M.L. REV. 327, 333 (2014).

160. Laura Choi, *Financial Stress and Its Physical Effects on Individuals and Communities*, COMMUNITY DEV. INV. REV. (Fed. Res. Bank, S.F., Cal.), Jan. 2009, at 120, https://www.frbsf.org/community-development/files/choi.pdf.

161. THE CTR. FOR CREDIT UNION INNOVATION, LLC, FINANCIAL STRESS AND WORKPLACE PERFORMANCE: DEVELOPING EMPLOYER-CREDIT UNION PARTNERSHIPS 1 (2002), https://p.widencdn.net/gkjrh3/1752-82CCUIFinancial_Stress.

162. Letter from the Ctr. for Responsible Lending et al., to Congress (Sept. 20, 2017) [hereinafter Lending Letter], http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-support-protectingconsumers-unreasonablerates-sep2017.pdf.

163. *Id.*

164. PEW CHARITABLE TR., s*upra* note 31, at 1.

165. *See* Saunders et al., *supra* note 17, at 22.

166. *See* JAKE HALPERN, BAD PAPER: CHASING DEBT FROM WALL STREET TO THE UNDERWORLD 24–27 (2014).

167. Sobol, *supra* note 159, at 334.

When borrowers cannot afford to pay back the high rates of interest, they may externalize the cost in several ways. Studies have determined that individuals taking out payday loans, which often come with exorbitant interest rates, are more likely to fail to make child support payments and are more likely to be on government food assistance benefits.[168] Increased access to credit among low-income borrowers has been linked to decreased ability to keep up with mortgage payments, rent, and utility bills.[169] Nonpayment of these bills necessarily leads to increased costs for other consumers as mortgage lenders, landlords, and utility companies must recoup lost income from other sources. Many consumers trapped by high-interest rate debt will eventually file formally for bankruptcy or become informally bankrupt.[170]

Restricting the ability of third-parties to charge usurious rates of interest may affect the prices of notes on the secondary market. Critics of the Second Circuit's opinion in *Madden* have argued that this will drive down the price of notes on the secondary market.[171] But one of the most common ways in which notes end up on the secondary market is by being sold after borrowers default.[172] Decreasing the price these loans can be sold for would encourage lenders to make a greater effort to verify that borrowers can actually pay back the loans they are making.

After the housing market collapse of 2005 to 2007, Congress took steps to regulate borrower qualifications.[173] Decreasing the price which defaulted notes can be sold at on the secondary market will have the effect of imposing lender responsibility in the consumer context.

IV. ROLE OF REGULATION IN THE CONTEXT OF CONSUMER LENDING

The practice of charging consumers usurious rates of interest should be limited to banks because these institutions are highly regulated and are

168. *See* Brian T. Melzer, *Spillovers from Costly Credit*, 31 REV. FIN. STUD. 3568, 3575–88 (2018) (finding low-income households with immediate access to payday loans display greater economic distress, usage of food assistance benefits, and delinquency on child support payments than others without payday loan access).

169. *See* Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q. J. ECON. 517, 526–50 (2011) (finding loan access increases households' difficulty in paying mortgage, rent, and utilities bills).

170. Characterized as a consumer engaging in "chronic non-repayment absent a bankruptcy filing." Amanda E. Dawsey, *Externalities Among Creditors and Personal Bankruptcy*, J. FIN. ECON. POLICY, 2014, at 2–3.

171. *See* Horn & Hall, *supra* note 34, at 22.

172. *See* HALPERN, *supra* note 166, at 5.

173. *See, e.g.*, 15 U.S.C. § 1602 (2012).

subject to multiple layers of public oversight.[174] These public agencies and the officials who staff them provide a vital check against consumer abuse.

A. Overview of Bank Regulatory Structure

By federal statute, all national banks are subject to a "full-scope, on-site examination" every year by their designated federal regulator.[175] Additionally, the regulatory agencies have discretion to conduct specialized, on-site examinations to ensure compliance with consumer protection laws.[176] All federally-chartered banks are regulated by the OCC, an independent arm of the U.S. Treasury Department.[177] All federally-insured depository institutions are subject to regulation by either the OCC, the Board of Governors of the Federal Reserve System (FED) or the FDIC.[178] There are even extra protections built into this system whereby one regulator can step in to examine institutions which are primarily the responsibility of another agency if circumstances warrant it.[179] To ensure this system of oversight keeps pace with changes and innovations in the industry, Congress created the Federal Financial Institutions Examination Council, on which executives from the OCC, the FDIC, the FED, the Federal Home Loan Bank Board, and the National Credit Union Administration Board sit, to coordinate the efforts of the various agencies and suggest changes to structure or practices.[180] State bank examiners provide additional insight and assistance through a standing State Liaison Committee.[181] All of this oversight numerous regulatory agencies conduct makes banks uniquely harmless among debt holders in terms of unscrupulous, irresponsible, or predatory practices.

Evidence suggests subprime lending, a root cause of the 2008 financial crisis,[182] is primarily extended by non-depository institutions.[183] The FED has indicated the reason for this is that non-depositories have a much higher risk tolerance because their loan practices are not subject to

174. *See, e.g.*, GEISST, s*upra* note 21, at 61–64 (outlining the basic regulatory structure of federally insured banks).
175. 12 U.S.C. § 1820(d)(1) (2012).
176. CARNELL ET AL., *supra* note 33, at 631.
177. 12 U.S.C. § 1813(q)(1) (2012).
178. *Id.* § 1813(q)(1)–(3).
179. CARNELL ET AL., *supra* note 33, at 632.
180. 12 C.F.R. § 1101.2 (2018).
181. 12 U.S.C. § 3301 (2012).
182. ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 464 (5th ed. 2017).
183. CARNELL ET AL., *supra* note 33, at 380.

regulatory examination.[184]

Not allowing third parties to enjoy the benefit of federal preemption would encourage lenders to charge reasonable rates of interest. Or if their business models necessitate charging rates above their state limit, debt holders could affiliate themselves with a regulated bank. This would bring them within the purview of that bank's designated regulator.[185] Or in some states, they could obtain a state lending license.[186] The latter option has become popular in the Second Circuit since *Madden*.[187] Both approaches are more favorable for consumers because they increase the level of oversight on the debt holder.[188]

B. Problems in the Third-Party Debt Collection Industry

Defaulted debt originated by banks or other legitimate lenders often winds up in the hands of third-party debt collection agencies.[189] Many of these agencies have little regard for debtors or following the law.[190] Collection agencies have been found to engage in many nefarious practices, such as: "(1) evading U.S. laws by outsourcing debt collection overseas, (2) using technology to target the most vulnerable debtors for aggressive collection, (3) exploiting small-claims courts to obtain judgments that would not be granted in normal litigation, and (4) pursuing old debts after the statute of limitations has expired."[191] The Federal Trade Commission and the Consumer Financial Protection Bureau (CFPB) consistently receive more consumer complaints about debt collectors than any other industry.[192]

Consumers most vulnerable to abuse from third-party debt collectors are the elderly, disabled, and low income.[193] Uncertainty about their legal rights, the relatively small amount of money involved, a short, one-year statute of limitations, restrictions on punitive damages, and the procedural difficulties of litigation make an adequate remedy unattainable for most debtors.[194]

These firms have no incentive to consider the well-being of their consumers. Lenders' business models are dependent on reputation and

184. *Id.*
185. 12 U.S.C. § 1820(b)(4)(A) (2012).
186. *See* Horn & Hall, *supra* note 34, at 22.
187. *Id.*
188. *See* 12 U.S.C. § 1820(b)(4)(A); Horn & Hall, *supra* note 34, at 22.
189. *See* HALPERN, *supra* note 166, at 5.
190. *See generally id.* (chronicling the notoriously corrupt Buffalo collections industry).
191. Goldberg, *supra* note 33, at 729.
192. Sobol, *supra* note 159, at 336–37.
193. *Id.* at 366.
194. *Id.*

repeat business, giving them an incentive to fairly treat debtors.[195] But collection agencies get their business from lenders, so consumers have no ability to avoid disreputable firms once they purchase their debt.[196] Therefore, collection agencies have little incentive to fairly treat debtors.[197] These collection agencies are not the intended beneficiaries of federal preemption and their benefitting is to the detriment of consumers.[198]

C. Effect on the Secondary Credit Market

It has been argued that in the modern age of consumer finance, which is heavily reliant on the secondary credit market,[199] disallowing third-party debt buyers the benefit of federal preemption of state usury laws might have a secondary effect of limiting the supply of credit for marginal borrowers.[200] This argument has some validity; the idea that price ceilings have a tendency to restrict supply and even result in shortages is economically uncontroversial.[201]

While the premise is correct, its conclusion is ignorant to usury law's purpose. Legislators throughout the country intend to limit the supply of this type of credit because they believe it is harmful for consumers.[202] This is the type of public policy determination that state legislators are uniquely qualified to make. No one would suggest that the availability of consumer credit is not both necessary and beneficial for consumers in some circumstances. But the same could be said for all manner of potentially hazardous products, such as lottery tickets, opioids, and fireworks. This accurate observation obviously does not lead to the conclusion that all limitations on the sale of these products should be repealed. We would be hesitant to allow one or two states to repeal all regulation on these products and distribute them across the country with impunity. Congress implicitly acknowledged the importance of states' ability to protect local consumers when it adopted state usury rates instead of supplanting them with rates of its own design.[203] The judiciary should be more hesitant to accept legal arguments that have the effect of

195. GEORGE J. MAILATH & LARRY SAMUELSON, REPEATED GAMES AND REPUTATIONS LONG-RUN RELATIONSHIPS 9 (2006).

196. *See* HALPERN, *supra* note 165, at 22.

197. Sobol*, supra* note 159, at 331.

198. *See* 12 U.S.C. § 85 (2012).

199. CARNELL ET AL., *supra* note 33, at 380.

200. Honigsberg et al., *supra* note 22, at 8.

201. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 470 (9th ed. 2014).

202. *See, e.g.*, N.Y. Governor's Bill Jacket, L. 1968 Ch. 349, at 20–21 (letter in opposition to minor rate increase).

203. *See* 12 U.S.C. § 85.

stripping state consumer protections of the substance which Congress clearly intended for them to retain.

V. THE VALID-WHEN-MADE DOCTRINE

The so-called "valid-when-made" doctrine has been cited as controlling when a note is sold in another state.[204] According to this argument, if a loan is legal at the time it is made, then any subsequent note holder can enforce its interest rate against the borrower.[205] This doctrine is supported by scant precedent and is poorly suited to govern modern consumer contracts. This argument relies heavily on precedent from nearly two centuries ago, which concludes that one of the "cardinal rules in the doctrine of usury" is that "a contract, which, in its inception, is unaffected [sic] by usury, can never be invalidated by any subsequent usurious transaction."[206]

Nichols and *Gaither* stated a rule which is potentially subject to a broad interpretation. But the transactions their rule was applied to are substantially distinct from those which its proponents now wish to apply the rule to. Both cases determined issues of allegedly improper discounting of loans.[207] Discounting is essentially selling a note for less than face value.[208] For example, a creditor who extends $100 credit to a borrower must pay back the principal $100, plus $10 in interest at the end of one year in a state with a fifteen percent usury rate. This is a hypothetical interest rate of ten percent and would be lawful. If the creditor assigns that note in exchange for fifty dollars (a fifty percent "discount") and the borrower repays the loan to the assignee in full, this yields a rate of return for the assignee of twenty percent. The ruling in *Nichols* clarifies that this transaction would not cause a loan which was legal in its inception to suddenly become usurious just because of an increase in the rate of return earned by the assignee.[209]

Contrast this with lenders who make high-interest rate loans in one state merely to transfer them to assignees in other states where they could not have lawfully made the loan themselves. In both *Nichols* and *Gaither*, the assignees would have been able to lawfully make the original loans at issue at the original interest rates themselves. Third-party debt holders

204. Note, *Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015): The Second Circuit Threatens to Disrupt Capital Markets*, 8 NEB. L REV. BULL 1, 3–4 (2017).
205. *See* Horn & Hall, *supra* note 34, at 15.
206. Nichols v. Fearson, 32 U.S. 103, 109 (1833); *see also* Gaither v. Farmers & Mechs. Bank, 26 U.S. 37, 43 (1828).
207. 32 U.S. at 105; 26 U.S. at 39.
208. *Discount*, BLACK'S LAW DICTIONARY (2d ed. 1995).
209. *See* 32 U.S. at 109.

relying on this precedent are dealing with loan originators in states with permissive usury laws to make loans which they would be prohibited from making otherwise.

In addition to the factual differences, it is also important to recognize that *Nichols* was decided over a century before *Erie R.R. v. Tompkins* altered the effect of federal jurisprudence on state contract law.[210] Under the modern legal framework of our federalist system, substantive contract law is determined by state courts unless Congress or the Constitution indicate otherwise; "[t]here is no federal general common law."[211] Legal arguments suggesting the applicability of the "valid-when-made" doctrine to consumer debt contracts relying on *Nichols* are not as definitive as their proponents suggest because federal contract law does not bind the states.[212]

Some states may have adopted the approach the Supreme Court outlined in *Nichols.* In those states, the legal case for the application of this rigid doctrine is much stronger. But of the few state cases citing *Nichols* since *Erie*, none have done so in support of the idea that transferring a note cannot make the underlying obligation usurious.[213] Even reaching back to the pre-*Erie* era, application of valid-when-made has been most commonly used to confront factual dissimilar issues such as how to treat a note made in reliance on a state usury law where the state legislature decreases the limit to below the rate of that note.[214]

Even conceding that the valid-when-made doctrine is good law and applicable to out-of-state, third-party debt buyers, the practical case for its application is highly suspect. The drafters of the NBA could not have

210. *See generally Nichols*, 32 U.S. 103 (indicating the U.S. Supreme Court decided the case in 1833, over 100 years before *Erie*); *see* 304 U.S. 64, 78 (1938).

211. *Erie*, 304 U.S. at 78.

212. *Id.*

213. *See* Indus. Nat'l Bank v. Stuard, 318 A.2d 452, 453 (R.I. 1974) (accelerating loan upon default does not render it usurious); Messersmith v. Reilly, 296 N.W. 920, 922 (N.D. 1941) (citing Nance v. Gray, 38 So. 916, 919 (Ala. 1904)) (making subsequent agreement for debtor to pay additional interest, which in aggregation with the interest stipulated in the original loan agreement constitutes usury, has no bearing on the enforceability of the original agreement); State *ex rel*. Beck v. Assocs. Disc. Corp., 96 N.W.2d 55, 73 (Neb. 1959); Hafer v. Spaeth, 156 P.2d 408, 410 (Wash. 1945) (citing for another purpose), *overruled by* Whitaker v. Spiegel, Inc., 637 P.2d 235 (Wash. 1981); Wayne Pump Co. v. Dep't of Treasury, 110 N.E.2d 284, 287 (Ind. 1953) (citing for another purpose); *In re* Bank of N.Y. & Fifth Ave. Bank, 116 N.Y.S.2d 57, 59 (App. Div. 1952) (citing for another purpose), *aff'd*, *In re* Smith's Will, 113 N.E.2d 154 (1953).

214. *See* Adams v. Shirk, 117 F. 801, 805 (7th Cir. 1902); *see also* Vines v. Tift, 7 S.E. 227, 227 (Ga. 1887); Curry v. Adams' Adm'r, 57 S.W. 8, 8–9 (Ky. 1900); Mix v. Fid. Tr. & Safety-Vault Co., 44 S.W. 393, 394 (Ky. 1898); Farmers Bank v. Henry Cty. Tr. Co., 15 Ky. L. Rptr. 96, 96 (Ky. 1893).

contemplated modern business practices, just as the *Marquette* Court did not contemplate how lending practices would develop in the age of the internet. Today, a bank can incorporate in a state with a negligible presence in that state, solely for the purposes of getting access to a favorable usury limit, and then, without taking on any risk to itself (indeed without incurring any profit or loss whatsoever), can immediately transfer debt on issuance to a non-bank, non-regulated entity operating in another state.[215] Debt originating in one state is regularly sold in the form of Excel spreadsheets on thumb drives from one collection agency to the next, with little incentive to regard state usury protections.[216] The ability to run roughshod over state usury laws cannot have been the intention, nor even within the contemplation of those who crafted the federal preemption doctrine surrounding usury.

Valid-when-made's application creates a rule contrary to the purpose of the NBA. The plain language of the statute gives effect to the notion that the laws of the several states ought to be binding.[217] Allowing debt holding institutions to circumvent state usury laws is an inapposite result considering "[t]he purpose of Section 85 is to adopt the state law, relating to interest rates permitted . . . ."[218] The Supreme Court confirmed in *Watters* that "contracts made by national banks 'are governed and construed by State laws' and national banks' 'acquisition and transfer of property [are] based on state law' . . . ."[219] Congress recognized these traditional common law areas were best determined by state judiciaries.[220] And the Court has recognized the import with which state law was intended to retain, despite the seemingly ever-expanding scope of the NBA: "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."[221] It also impliedly endorsed state legislators' judgment about the appropriate usury rates by declining to supplant state rates in the NBA.[222] Courts ought to respect the clear intent of Congress and reject the application of this outdated doctrine.

215. *See* Mason, *supra* note 66, at 26.
216. HALPERN, *supra* note 166, at 5.
217. *See* 12 U.S.C. § 85 (2012).
218. United Missouri Bank, N.A. v. Danforth, 394 F. Supp. 774, 779 (W.D. Mo. 1975); *see* 12 U.S.C. § 85.
219. Watters v. Wachovia Bank, N.A., 550 U.S. 1, 11 (2007) (alteration in original) (citing Nat'l Bank v. Commonwealth, 76 U.S. 353, 362 (1869)), *superseded by statute*, Dodd-Frank Act, Pub. L. No. 111-203, §§ 1044(a), 1045, 1047(a), 124 Stat. 1376, 2014, 2017–18 (2010).
220. *See* 12 U.S.C. § 85.
221. *Watters*, 550 U.S. at 11 (citing Davis v. Elmira Sav. Bank, 161 U.S. 275, 290 (1896)).
222. *See* 12 U.S.C. § 85.

Valid-when-made is an outdated legal doctrine which has been over applied to situations for which it was not designed. Support for the valid-when-made doctrine comes primarily from federal courts,[223] whose interpretation of common law contract principals does not control the transfer of promissory notes between originators and third-party debt buyers.[224] Practically, it promotes a form-over-substance approach to consumer protection, and its application in this context contravenes Congress's intent in the NBA to adopt state law usury rates.[225]

VI. PENDING LEGISLATION

In 2017, North Carolina Representative Patrick McHenry introduced a bill which would codify the valid-when-made doctrine, making it a permanent feature of federal commercial law.[226] The bill adds language to the federal statutes governing usury law for federally insured banks,[227] explicitly granting them the right to assign the benefit of federal preemption to debt buyers.[228] In a letter to Congress denouncing the bill, which 152 public interest organizations endorsed, including the NAACP and the National Association of Consumer Advocates, the Center for Responsible Lending claims that the bill "would make it easier for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use 'rent-a-bank' arrangements to charge high rates on loans" and that it "could open the floodgates to a wide range of predatory actors to make loans at 300% annual interest or higher."[229]

On the other side, endorsing this relatively obscure piece of legislation are financial services corporations such as notorious payday lender Enova Financial.[230] The dangers of traditional payday lending are well-documented.[231] But Enova Financial has the particularly dubious distinction of being the number one recipient of consumer complaints at

223. *See* Nichols v. Fearson, 32 U.S. 103, 109 (1833); Gaither v. Farmers & Mechs. Bank, 26 U.S. 37, 43 (1828).

224. *See* Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938).

225. *See* 12 U.S.C. § 85.

226. Protecting Consumers' Access to Credit Act of 2017, H.R. 3299, 115th Cong. § 3.

227. *See* 12 U.S.C. §§ 85, 1463(g), 1785(g), 1831d (2012).

228. H.R. 3299 § 3. A loan that is valid when made as to its maximum rate of interest in accordance with this section shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any state law to the contrary.

229. Lending Letter, *supra* note 162.

230. Zach Carter, *Democrats May Deny It, but This Bill Is a Handout to Payday Lenders*, HUFFPOST (Nov. 16, 2017, 9:31 AM), https://www.huffingtonpost.com/entry/gwen-moore-payday-lenders_us_5a0c9300e4b0b17ffce214ff.

231. *See, e.g.*, Melzer, *supra* note 168.

the CFPB.[232] If Congress allows this bill to pass it would be offering a huge giveaway to peddlers of high-interest credit like Enova who take advantage of borrowers, many of whom are of limited means. This bill would negate state legislatures' best effort to protect consumers.[233]

CONCLUSION

Third-parties who purchase debt from banks should comply with usury laws in the states where they operate. Although federal law allows for banks to export the usury laws of their home state to customers in other states,[234] there is no justification for dramatically expanding this power. Allowing third-parties who purchase bank notes to benefit from the NBA and DIDMCA's preemption of state usury laws is legally incorrect and harmful to consumers.

High-interest lending poses serious financial risks to borrowers.[235] Consumers who utilize high-interest debt are incurring a substantial cost for a short-term benefit.[236] Serious harm can result when these transactions take place without regulatory supervision.[237] Repercussions include cyclical borrowing and financial ruin.[238] Many consumers who become trapped in this cycle will never emerge.[239] By limiting federal preemption of state usury laws to regulated banks, states can offer these borrowers some measure of protection. Banks are highly regulated entities.[240] They are subject to supervision by various government actors.[241] Monitoring their compliance with consumer protection laws is much easier than it is for the thousands of lightly regulated debt buyers and payday lenders operating throughout the country. Additionally, when banks can sell their defaulted notes at any interest rate, it decreases banks' incentive to charge reasonable rates and ensure customers have the ability and propensity to repay loans before extending credit.[242]

Federal preemption of state usury laws was intended to be for the

232. MIKE LITT & EDMUND MIERZWINSKI, U.S. PIRG EDUC. FUND, PREDATORY LOANS & PREDATORY LOAN COMPLAINTS: THE CFB'S CONSUMER COMPLAINT DATABASE SHOWS THE NEED TO STOP PAYDAY DEBT TRAPS 2 (2016), https://uspirg.org/sites/pirg/files/reports/USPIRG%20Payday%20Report.pdf.

233. *See, e.g.*, Lending Letter, *supra* note 162.

234. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 309–10 (1978).

235. *See* Choi, *supra* note 160, at 22.

236. *See id.*

237. *See* Goldberg, *supra* note 33, at 779.

238. Montezemolo & Wolff, *supra* note 18, at 4.

239. *Id.*

240. *See, e.g.*, 12 U.S.C. § 1820(d)(1) (2012).

241. *See* Kaouris, *supra* note 81, at 966.

242. *See* Sobol, *supra* note 159, at 331.

benefit of banks.[243] Depository institutions are essential to the health of the national economy. Therefore, Congress granted them special operating privileges.[244] Despite the courts' gradual expansion of banks' right to export their home state usury laws for over a century, no court has held that federal preemption of state usury laws extends to third-party debt buyers not affiliated with a bank. State law is said to interfere with federal banking law when it significantly interferes with a bank's powers under the NBA or DIDMCA.[245] The ability of a bank to assign its usury privileges to a third-party is not explicitly listed in federal law as a bank power,[246] and stretching the meaning of implied powers so far as to encompass these transactions is manifestly unreasonable.

Whether the valid-when-made-doctrine should allow a third party to categorically charge interest rates at any level so long as the debt is originated at a bank located in a state with a permissive usury law is ultimately a question for state courts to decide.[247] State courts should reject the valid-when-made doctrine. Considering technological developments which allow lenders to reach borrowers anywhere in the country with minimal effort, the application of the valid-when-made doctrine has had a nefarious and overstated influence on the consumer credit market. It renders state usury laws ineffective and has contributed to the financial hardships of millions of consumers.[248] When creative lawyers use anachronistic precedent to erode the usefulness of important consumer protections and allow businesses to subvert their intended effects, courts and legislators owe it to consumers to revitalize those rules, whether by statute or by decision, to reassert their intended effect.

243. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 314 (1978).
244. *Id.*
245. Barnett Bank, N.A. v. Nelson, 517 U.S. 25, 33 (1996).
246. 12 U.S.C § 24 (2012).
247. *See* Erie R.R. v. Tompkins, 304 U.S. 64, 78 (1938).
248. *See* FED. RESERVE BANK OF N.Y., *supra* note 8.