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New York Federal Trial Court Provides Madden Relief for Bank Partnerships

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In a decision favorable to the continued vitality of bank partnerships, a federal trial court in New York recently ruled in favor of federal preemption on behalf of a national bank and its agent. In *Edwards v. Macy's Inc.*, 2016 U.S. Dist. LEXIS 31097 (S.D.N.Y. March 9, 2016), the court concluded that federal law preempted a lawsuit raising state law claims under an unfair deceptive acts and practices statute against a national bank and its nonbank partner. In so doing, the court rejected the consumer's assertion that the U.S. Court of Appeals for the Second Circuit's decision in *Madden v. Midland Funding* should allow the claims to proceed against the nonbank partner.

Brenda Edwards, a Massachusetts resident, obtained a store credit card from Macy's Inc. issued through Department Stores National Bank, a national bank headquartered in South Dakota. Sometime in early 2011, Edwards claims that the Bank enrolled her in a debt cancellation program. She did not notice the charges associated with the debt cancellation program until April 2014. Edwards, who is self-employed, contacted Macy's for a refund, noting that she had not enrolled in the debt cancellation program and, in any event, she would not have qualified for it because of her self-employed status. Macy's gave her a small refund and Edwards subsequently sued for violations of the South Dakota UDAP statute and related state law claims.

The Bank and Macy's moved to dismiss, noting that federal law preempted the claims because the Bank was not subject to these state law claims. Specifically, they noted that the Office of the Comptroller of the Currency's debt cancellation rule at Part 37 in the Code of Federal Regulations preempted all of the claims. The U.S. District Court for the Southern District of New York agreed. The court noted that Part 37 expressly preempts state law claims. Even without such express preemption, the court found that the claims would be barred by implied preemption, as the federal regulations are so comprehensive as to leave no room for state law or regulation. Edwards' claims, which related to enrollment practices, failure to determine eligibility for the program, failure to provide disclosures and the calculation of fees for the program, were all subject areas covered in Part 37. Thus, the court dismissed the lawsuit.

Edwards seemed to understand that her claims against the Bank would likely be preempted, but she pushed forth separately on her claims against Macy's. Edwards specifically attempted to rely on *Madden* in connection with her claims against Macy's. In *Madden*, the Second Circuit - which includes Connecticut, New York, and Vermont - held that non-national bank entities that purchase loans originated by national banks cannot rely on the National Bank Act to protect them from state-law usury claims. According to the summary of *Madden* provided by the *Edwards* court, such non-bank parties cannot enjoy the bank's federal preemption unless they act as an agent or subsidiary of the bank or

otherwise act on behalf of the bank in carrying out the bank's business. Citing *Madden*, Edwards argued that even if federal law preempted her claims against the Bank, the claims against Macy's should stand because "Macy's has not exercised any national bank powers nor has it acted on behalf of a national bank in carrying out a national bank's powers."

The *Edwards* court distinguished its facts from *Madden*, noting that although Macy's is not a bank or a subsidiary of a bank, Macy's was acting on behalf of the Bank in carrying out the Bank's business. The court referred to Edwards' complaint, which stated that Macy's provides "marketing services, credit processing, collections, and customer service related to credit card accounts and ancillary products … and receives compensation for those services." The *Edwards* court concluded that "the language could not be clearer: Macy's was to provide marketing, credit processing, collections and customer service related to [the debt cancellation program], and it was compensated for doing so. Macy's was, therefore, conducting those activities on [the Bank's] behalf."

The language in the *Edwards* decision, although a trial court decision, should provide a balm for nonbank partners in the bank partnership space. To the extent that a bank partnership is structured as an arrangement in which the nonbank partner acts on behalf of the bank in carrying out the bank's business, bank partnerships can certainly look to the language of the *Edwards* decision for the idea that bank partnership arrangements should be treated differently than the sale of defaulted debt to a nonbank debt buyer (which was the form of the transaction in *Madden*). Indeed, by partnering with nonbank service providers, banks are able to market services, generate loan volume, and reach customers that they may not otherwise be able to reach, especially in an online environment, thus allowing banks to fully exercise their federally-granted powers to act as a lender.

The Federal Deposit Insurance Corporation, the federal regulator of many banks involved in such bank partnerships, recently favorably discussed partnerships between its member banks and partners in its Winter 2015 issue of *Supervisory Insights*. The FDIC reaffirmed its prior guidance to participants in the bank partnership space. In *Supervisory Insights*, the FDIC walked through factors a bank should examine before entering into a partnership with a nonbank entity. The FDIC directs its member banks to consider the partner's compliance with applicable federal law, consumer protection requirements, anti-money laundering rules and fair credit obligations, as well as applicable state laws such as licensing or registrations necessary to engage in the partnership. The FDIC also requires its banks to ensure that the partnership will meet the FDIC's safety and soundness requirements. The FDIC notes that banks can manage the risks posed by potential partnerships through proper risk identification, appropriate risk-management practices, and effective oversight of the nonbank partner.

We continue to await the U.S. Supreme Court's decision regarding whether it will grant certiorari in the Madden case. In the meantime, bank partnerships should take note of the favorable language in the *Edwards* decision to start to build out the defensible case that *Madden* never intended to reach their partnerships.

Edwards v. Macy's Inc.

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