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The Narrow Scope of Federal Preemption of State Regulation in Commercial Credit Transactions: A Comment on Decohen v. Capital One, N.A.

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THE NARROW SCOPE OF FEDERAL PREEMPTION OF STATE REGULATION IN COMMERCIAL CREDIT TRANSACTIONS: A COMMENT ON *DECOHEN V. CAPITAL ONE, N.A.*

I. INTRODUCTION

Congress's power to codify banking customs and practices, establish a system of national banking, and provide national banks protections that prohibit states from infringing on the efficiency of the banking system dates from the seminal case of *McCulloch v. Maryland*[1] and the enactment the National Bank Act (NBA) in 1864.[2] The United States Supreme Court announced the preemption standard in *Watters v. Wachovia Bank, N.A.*[3] and emphasized that federal control of the banking system "shields national banking from unduly burdensome and duplicative state regulation," excepting only undiscriminating state laws of general application.[4] The federal policy of encouraging uninhibited institutional banking practices at times conflicts with the duty of states to safeguard consumers' rights in non-real estate lending transactions, and while courts are hesitant to apply the presumption against preemption, traditional theories of federal preemption provide little protection to national banks operating under the scope of the NBA.[5]

Last year, the United States Court of Appeals for the Fourth Circuit refused to apply the doctrine of federal preemption and held that Maryland state law required an assignee of a Retail Installment Sale Contract (RIC), which included an optional debt cancellation agreement, to cancel the borrower's remaining loan balance upon occurrence of a condition in the contract.[6] After a close reading of the NBA, Office of the Comptroller of the Currency (OCC) regulations, and the contract terms in question, the court conducted a detailed analysis of the underlying transactions and found that the Maryland Credit Grantor Closed End Provisions (CLEC), which governed the loan agreement, were not preempted under the doctrines of express federal preemption, conflict preemption, or full

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1. 17 U.S. 316 (1819).

2. National Bank Act of June 3, 1864, ch. 106, 13 Stat. 100 (codified as amended at 12 U.S.C. §§ 21–216d (2006)); *see also* 12 U.S.C. § 25b (Supp. IV 2011) (clarifying preemption standards).

3. 550 U.S. 1 (2007).

4. *Id.* at 11 (citing Davis v. Elmira Sav. Bank, 161 U.S. 275, 290 (1896)).

5. For an overview of federal preemption standards, see generally Raymond Natter & Katie Wechsler, *Dodd-Frank Act and National Bank Preemption: Much Ado About Nothing*, 7 VA. L. & BUS. REV. 301, 308–10 (2012). As for presumptions pertaining to preemption:

> In general, the courts will apply a "presumption against preemption," especially in a field which the states have traditionally occupied. The presumption grows out of the Supreme Court's traditional "respect for the states as 'independent sovereigns in our federal system' which leads to the assumption that 'Congress does not cavalierly preempt state-law causes of action.'"

Id. at 310 (quoting Wyeth v. Levine, 555 U.S. 555, 565 n.3 (2009); Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).

6. Decohen v. Capital One, N.A., 703 F.3d 216, 227, 228–29 (4th Cir. 2012).

field preemption.[7] Therefore, the court found that the CLEC required Capital One—a national bank and an assignee of the original lender—to cancel the borrower's remaining loan balance under the contract.[8] Ultimately, the court reinforced its recent decision in *Epps v. JP Morgan Chase Bank, N.A.*,[9] demonstrating its unwillingness to invoke federal preemption doctrine and signaling its support of state consumer protection measures.

II. UNDERLYING TRANSACTIONS AND DISTRICT COURT OPINION

In September 2007, Philip Decohen purchased a vehicle from Nation Auto and entered into an RIC with Nation Auto to finance the purchase.[10] The RIC contained an optional debt cancellation agreement and a choice of law provision, which designated the Maryland Commercial Code and, specifically, the CLEC as the governing law.[11] Under the CLEC, debt cancellation agreements permit a borrower to cancel the remaining balance of the borrower's loan, less any insurance proceeds, if a "total loss" of the vehicle occurs.[12] The debt cancellation agreement in Decohen's loan agreement permitted him to cancel

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7. *Id.* at 224.

8. *Id.* at 229.

9. 675 F.3d 315 (4th Cir. 2012). In *Epps*, the court declined to apply the presumption against federal preemption because "the CLEC regulates an area with authorized federal presence." *Id.* at 322. However, the court found that "the degree to which the CLEC regulates an enumerated power of the national banks is merely incidental" and held that the NBA did not preempt state CLEC repossession provisions. *Id.* at 322–23 (citing 12 C.F.R. § 7.4008(d)(1) (2011)). Further, the court recognized that "national banks are subject to state law regarding collection of debts." *Id.* at 324.

10. *Decohen*, 703 F.3d at 219. Nation Auto's predecessor in interest was Abbasi, LLC, a named defendant in the district court case. *See* Decohen v. Abbasi, LLC, No. WDQ-10-3157, 2011 WL 3438625, at *1 (D. Md. July 26, 2011), *vacated in part sub nom.* Decohen v. Capital One, N.A., 703 F.3d 216 (4th Cir. 2012).

11. *Decohen*, 703 F.3d at 219. The RIC also contained a Federal Trade Commission "Holder Notice" required under federal law. *See id.* (referring to holder notice required by 16 C.F.R. § 433.2 (2012)). The district court characterized the debt cancellation agreement as a "Guaranteed Asset Protection Deficiency Waiver Addendum" (GAP Agreement), which contained the following relevant language:

> The named Customer is responsible to the named Dealer/Assignee under the terms of the [Credit Contract] for the amount of any early termination liability resulting from a Total Loss of the Vehicle. Due to this addendum being in effect, the Dealer/Assignee agrees to cancel a portion of the Customer's indebtedness in the event of a Total Loss of the Vehicle as defined herein.
>
> The [GAP Agreement] will pay the amount equal to the Unpaid Net Balance less the Actual Cash Value (ACV) of the Vehicle both as defined herein.

Decohen, 2011 WL 3438625, at *1.

12. *Decohen*, 703 F.3d at 228–29 (citing MD. CODE. ANN., COM. LAW § 12-1001(h) (LexisNexis 2005 & Supp. 2012)).

only a portion of the debt owed rather than the entire balance of the loan and, thus, failed to comply with the CLEC.[13]

When Beacon Industries Worldwide, Inc.—the servicer of the agreement—denied Decohen's claim to rescind the loan, Decohen brought a putative class action, alleging violations of the CLEC, Maryland Consumer Protection Act, and Maryland Retail Installment Sales Act, and asserted claims for breach of contract, declaratory relief, restitution, and unjust enrichment.[14] The United States District Court for the District of Maryland found that the NBA preempted Decohen's CLEC claim; that Capital One's status as assignee, rather than obligee, did not change the preemption analysis; and that, ultimately, the NBA and CLEC did not require Capital One to rescind the loan.[15]

III. FOURTH CIRCUIT APPEAL

A. The National Bank Act and State Credit Regulations

On appeal, the Fourth Circuit reviewed de novo the district court's grant of Capital One's motion to dismiss and briefly recounted the history of the NBA and Congress's power to preempt state laws that infringe on federally protected rights of national banks.[16] The court then described the three types of federal preemption: express preemption, conflict preemption, and field preemption.[17] The court explicated the NBA and OCC regulations and, applying the plain

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13. *Id.* at 219; *see also Decohen*, 2011 WL 3438625, at *1 ("The GAP Agreement . . . stated that it 'may not necessarily pay off the Unpaid Net Balance due by the customer' . . . .").

14. *Decohen*, 2011 WL 3438625, at *1–2 (citing MD. CODE ANN., COM. LAW §§ 12-601–636, 12-1001–1029, 13-101–501 (LexisNexis 2005 & Supp. 2012)). Capital One removed the case to federal district court pursuant to the Class Action Fairness Act. *Id.* (citing 28 U.S.C. §§ 1332(d)(2), 1453 (2006 & Supp. IV 2010)).

15. *Id.* at *5–6 (citing OCC Interpretive Letter No. 1095 from Julie L. Williams, First Senior Deputy Comptroller & Chief Counsel, Comptroller of the Currency Adm'r of Nat'l Banks, to Paul D. Egide, Dir., Wisc. Dep't of Fin. Insts. (Feb. 27, 2008), *available at* http://www.occ.gov/static/interpretations-and-precedents/mar08/int1095.pdf). The district court first found that the parties had not entered into a true debt cancellation agreement not because it provided for the cancellation of only a part of the remaining loan balance, but because the agreement impermissibly provided that the actual cash value of the car would be its retail guide value. *Id.* at *3–4 (citing MD. CODE ANN., COM. LAW § 12-1002(b) (LexisNexis 2005)). Thus, the court found that the agreement in question was beyond the purview of the CLEC. *Id.* at *4. In granting Capital One's motion to dismiss, the district court found that Decohen failed to state a claim for breach of contract and that his other claims failed on the merits. *Id.* at *5 & n.10. However, the district court concluded that Decohen's loan agreement *did* contain a debt cancellation agreement for purposes of the preemption analysis. *Id.* at *6.

16. *See Decohen*, 703 F.3d at 222–23 (citations omitted).

17. *Id.* at 223. Express preemption occurs where "Congress expressly states its intent to preempt state law." *Id.* (citing Cox v. Shalala, 112 F.3d 151, 154 (4th Cir. 1997)). Full field preemption occurs where "Congress occupies a certain filed by 'regulating so pervasively that there is no room left for the states to supplement federal law.'" *Id.* (quoting *Cox*, 112 F.3d at 154). Finally, conflict preemption arises when a "state law is preempted 'to the extent it actually conflicts with federal law.'" *Id.* (quoting *Cox*, 112 F.3d at 154).

language of the regulations to the underlying transactions, concluded that federal law did not preempt the CLEC under any of the three preemption standards.[18]

1. Express Preemption

At the time of the transaction, OCC regulations expressly preempted state laws "that obstruct[ed], impair[ed], or condition[ed] a national bank's ability to fully exercise its Federally authorized non-real estate lending powers"[19] regarding, most notably, state laws concerning

> [t]he terms of credit, including the schedule for repayment of principal and interest, amortization of loans, balance, payments due, minimum payments, or term to maturity of the loan, including the circumstances under which a loan may be called due and payable upon the passage of time or a specified event external to the loan.[20]

However, the NBA regulations include a sweeping "savings clause," which permits state regulation on the subjects of contracts, rights to collect debts, and the acquisition and transfer of property in non-real estate lending.[21] Further, OCC regulations provide that federal law governs only debt cancellation agreements that national banks enter into.[22] Federal law also governs debt cancellation agreements in loans that national banks directly originate and loans that national banks purchase from other lenders.[23] Therefore, the threshold question is whether a national bank at any time "entered into" a debt cancellation agreement.[24] Thus, federal law would expressly preempt the CLEC only if Capital One had directly "entered into" the debt cancellation agreement with Decohen, either at the time of loan origination or at the time Capital One purchased the loan from Nation Auto.[25]

Here, the initial loan agreement between Decohen and Nation Auto, the original lender, contained the debt cancellation agreement.[26] Nation Auto assigned the RIC, unaltered, to Capital One.[27] Therefore, Capital One, the

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18. *Id.* at 223–25 (citations omitted).

19. 12 C.F.R. § 7.4008(d) (2011). Subsequently, the OCC removed this language in implementing provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. *See* Dodd-Frank Act Implementation, 76 Fed. Reg. 43,549, 43,556 (July 21, 2011) (codified at 12 C.F.R. § 7.4008(d) (2012)).

20. 12 C.F.R. § 7.4008(d)(4) (2012).

21. *See id.* § 7.4008(e).

22. *See* 12 C.F.R. § 37.1(c).

23. *See id.*; *see also* OCC Interpretive Letter No. 1095, *supra* note 15, at 3 ("[N]ational banks are authorized to enter into [debt cancellation agreements] with respect to loans they purchase as well as loans they originate directly.").

24. *See* 12 C.F.R. § 37.1(c).

25. *See* Decohen v. Capital One, N.A., 703 F.3d 216, 224 (4th Cir. 2012).

26. *See id.*

27. *Id.*

national bank seeking preemption of the CLEC, neither offered nor entered into the debt cancellation agreement with Decohen.[28] Accordingly, the court found that based on the plain language of the NBA and OCC regulations, taken together with the facts of the underlying transactions, federal law did not expressly preempt the CLEC.[29]

2. Conflict and Field Preemption

Similarly, the court determined that although the CLEC allows the debtor to cancel the "remaining" balance of the loan and the OCC regulations allow the borrower to cancel "all or part of" the remaining debt, state law is not conflict preempted by federal law.[30] Theoretically, a borrower could cancel the entire remaining balance of her loan and be in compliance with both state and federal law.[31] Additionally, the court found that the federal policy supporting uninhibited national banking practices remains intact; the CLEC "does not stand as an obstacle to the objective of the federal law" because banks may enforce loans in accordance with "safe and sound banking practices" while the state still protects consumers' rights.[32] Thus, the CLEC does not conflict with federal regulations.[33]

The court then summarily concluded that Congress had not sufficiently "occupied the field with regard to debt cancellation agreements."[34] Because Congress had left room in the NBA for states to legislate on debt cancellation agreements that entities other than national banks enter into, the NBA did not preempt the CLEC under the doctrine of full field preemption.[35]

3. Additional Sources of Federal Preemption

The Fourth Circuit panel concluded that the NBA did not preempt state law because the CLEC is an undiscriminating law of general application—it does not treat national banks differently from all other lending institutions.[36] Unlike in

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28. *See id.*

29. *Id.*

30. *Id.* at 224–25 (quoting MD. CODE ANN., COM. LAW § 12-1001(h) (LexisNexis 2005 & Supp. 2012); 12 C.F.R. § 37.2(f) (2012)).

31. *See id.* at 225.

32. *Id.* (quoting 12 C.F.R. § 37.1(b)).

33. *Id.* at 224.

34. *Id.* The district court had relied on persuasive authority in concluding that federal law field preempts debt cancellation agreements because Congress provided a "'comprehensive scheme of [federal] regulation [that] leaves no room for state law.'" Decohen v. Abbasi, LLC, No. WDQ-10-3157, 2011 WL 3438625, at *6 (D. Md. July 26, 2011) (alteration in original) (quoting Spinelli v. Capital One Bank, 265 F.R.D. 598, 605 (M.D. Fla. 2009)), *vacated in part sub nom.* Decohen v. Capital One, N.A., 703 F.3d 216 (4th Cir. 2012).

35. *Capital One*, 703 F.3d at 224.

36. *See id.* at 226 (quoting *Statement of John D. Hawke, Jr., Comptroller of the Currency, Before the S. Comm. on Banking, Hous. & Urban Affairs, on Federal Preemption of State Laws,*

Epps, the *Decohen* court failed to acknowledge that the NBA's savings clause expressly excepts the CLEC from federal preemption as a law regulating contracts, debt collection, and the acquisition and transfer of property.[37] In *Epps*, the court specifically relied on the explicit language in the savings clause to excuse state laws of general application from federal preemption.[38] In contrast, the *Decohen* court merely cited its previous decision in *Epps* and resolved the case instead on common law and public policy grounds.[39] The court concluded that nondiscriminatory state laws regarding contracts, debt collection, and the acquisition and transfer of property, like the CLEC, "form the legal infrastructure" for banking practices and regulate all creditors—whether an obligee or assignee, or a national or local entity—operating within the state.[40] Moreover, the court opined that state laws of general application do not frustrate the federal interest in uninhibited national banking practices and that preemption would not further federal banking policy.[41]

Capital One argued that federal law should preempt the CLEC even though Capital One acquired the loan by assignment.[42] In particular, Capital One argued that banking institutions customarily obtain rights to payment by virtue of assignments; stringent state regulation requiring banks to cancel lucrative payment streams would curtail future fruitful lending and trading practices.[43] The court rejected Capital One's arguments—and the district court's holding—in finding that assignments necessarily alter the preemption analysis.[44] Further, the court held that assigning a loan to a national bank does not "cleanse" an underlying unlawful transaction.[45] The court reasoned that because Capital One must already comply with state usury and consumer protection laws regarding contracts, debt collection, and the acquisition and transfer of property rights, allowing the CLEC to control the present case would not unduly burden the bank.[46] Throughout its opinion, the Fourth Circuit endorsed Maryland's

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Washington, D.C., April 7, 2004, 23 OCC Q.J. 69, 71 (Sept. 2004) [hereinafter *Statement of John D. Hawke, Jr.*]); Epps v. JP Morgan Chase Bank, N.A., 675 F.3d 315, 320 (4th Cir. 2012) (quoting Watters v. Wachovia Bank, N.A., 550 U.S. 1, 11 (2007)).

37. *See Epps*, 675 F.3d at 325 (discussing the savings clause of 12 C.F.R. § 7.4008 (2012)).

38. *Id.* at 325–26 (citing 12 C.F.R. § 7.4008(e)).

39. *See Decohen*, 703 F.3d at 226–27 (citations omitted).

40. *Id.* at 226 (quoting *Statement of John D. Hawke, Jr.*, *supra* note 36, at 71).

41. *See id.* at 225–26 (citations omitted).

42. *See id.* at 225. Capital One specifically relied on the decision in *Aguayo v. U.S. Bank*, 658 F. Supp. 2d 1226 (S.D. Cal. 2009), *rev'd*, 653 F.3d 912 (9th Cir. 2011), for its policy arguments and for the proposition that Nation Auto's assignment should not alter the preemption analysis. *See Decohen*, 703 F.3d at 226.

43. *See Decohen*, 703 F.3d at 226.

44. *Id.* at 225.

45. *Id.* at 227. The court noted that the Eighth Circuit, in *Thomas v. U.S. Bank, N.A.*, 575 F.3d 794 (8th Cir. 2009), supported its contention that lenders and creditors cannot cleanse an illegal transaction by assigning a loan to a national bank. *Decohen*, 703 F.3d at 228 (citing *Thomas*, 575 F.3d at 800–01).

46. *See Decohen*, 703 F.3d at 226.

consumer protection code and implied the federal government's respect for states' expertise in governing non-real estate loan transactions.[47]

B. Breach of Contract Claim

Finally, the court addressed the substance of Decohen's claims and found that Decohen and Nation Auto freely bargained for the CLEC choice of law provision.[48] Under Maryland law, the debt cancellation agreement was illegal because it provided that the borrower could cancel only a portion of the remaining debt, upon the occurrence of a contractual condition.[49] Thus, since Capital One voluntarily assumed the terms of the loan agreement by accepting the assignment from the original lender, Capital One could not escape a suit for breach of contract merely because it did not directly enter into the loan transaction.[50] Accordingly, the court vacated the district court's judgment and held that the NBA and OCC regulations did not preempt the CLEC.[51] Based on the illegality of the underlying transaction, the court also found that Decohen established a claim for breach of contract.[52]

IV. CONCLUSION

Decohen cannot be cited as a landmark federal preemption case. Rather, *Decohen* may stand for the rule that in activity conducted after contract formation, national banks may no longer clutch the shield of federal preemption. The key language in the OCC regulations means that, at the time of contract formation, national banks are immune from suits based on state contract claims or unfair debt practices actions for debt cancellation agreements they "enter[] into."[53] However, after contract formation, state law may govern execution and other related contract activities.[54] Thus, national banks would no longer be immune from post-formation suits brought pursuant to state consumer protection laws.

Once contracts including debt cancellation agreements have been consummated, national banking practice should resume its normal course, and

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47. Additionally, the court further developed the policy rationales underlying its previous opinion in *Epps*. *See id.* (citing Epps v. JP Morgan Chase Bank, N.A., 675 F.3d 315, 318, 326 (4th Cir. 2012)). While the court in *Epps* refused to apply the presumption against preemption, it found that state usury laws are not conflict preempted by the NBA and OCC regulations. *Epps*, 675 F.3d at 322, 324.

48. *See Decohen*, 703 F.3d at 228.

49. *See id.* at 219.

50. *See id.* at 228 ("The assignment of the loan by Nation Auto to Capital One does not allow Capital One to escape the obligations Nation Auto voluntarily undertook.").

51. *See id.* at 227, 229.

52. *Id.* at 229.

53. *See* 12 C.F.R. § 37.1(c) (2012).

54. *See supra* notes 25, 40–41 and accompanying text.

institutions such as Capital One may continue collections operations pursuant to their status as assignees to the original loan transactions. Regardless, national banks do not require federal protection while executing installment sales contracts already sanctioned by federal law at their inception.

Although the Fourth Circuit has been unwilling to apply the presumption against federal preemption of state law,[55] the court will methodically apply the doctrine of federal preemption based on a close reading of the federal statutes at issue and a careful analysis of the underlying transactions.[56] Most notably, the court's holding in *Decohen* signals that the federal government respects the authority of the states to legislate and protect consumers' rights, especially in areas traditionally relegated to the states.

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55. *See* Epps v. JP Morgan Chase Bank, N.A., 675 F.3d 315, 321–22 (4th Cir. 2012).
56. *See Decohen*, 703 F.3d at 222–27 (citations omitted).