IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO
Judge R. Brooke Jackson

Civil Action No. 19-cv-01552-RBJ
(Appeal from Bankruptcy Adversary Proceeding NO. 18-1099-TBM)

In Re: RENT-RITE SUPERKEGS WEST LTD,

Debtor.

RENT-RITE SUPERKEGS WEST LTD,

Appellant,

v.

WORLD BUSINESS LENDERS, LLC,

Appellee,

ORDER ON BANKRUPTCY COURT'S DETERMINATION

This matter is before the Court on Rent-Rite SuperKegs West Ltd. ("Rent-Rite")'s appeal, ECF No. 7, of the judgment of the U.S. Bankruptcy Court for the District of Colorado ("Bankruptcy Court") on May 20, 2019, ECF No. 1-2. Judgment was entered for Appellee World Business Lenders, LLC ("WBL") and against Rent-Rite. This Court exercises jurisdiction over the appeal pursuant to 28 U.S.C. § 1334(a) and 28 U.S.C. § 158(a)(1). The Court has reviewed the record and the briefs of the parties, and it held a hearing on July 31, 2020. For the reasons set forth below, the Bankruptcy Court's judgment is REVERSED in part and REMANDED.

I. BACKGROUND

Bank of Lake Mills is a Wisconsin state-chartered bank. ECF No. 1-2 at 4. On April 19,

2016 it loaned $550,000 to CMS Facilities Maintenance ("CMS"), a Colorado-based corporation. *Id.* CMS executed a promissory note promising to repay the balance within one year at "a remarkably high interest rate" of "0.331123287671% per day until paid in full," or 120.86% per year. *Id*. at 5. The promissory note dictates that federal law and Wisconsin law govern. *Id.* It also states that it "is accepted by [Bank of Lake Mills] in Wisconsin," and that payment shall be received in Wisconsin. *Id.* at 4–5.

For reasons unknown, a third party, Yosemite Management LLC ("Yosemite"), executed a deed of trust pledging its Colorado real property ("the property") as security on CMS's promissory note a few days later on April 21, 2016. *Id*. at 5. The deed of trust dictates that federal law and "the law of the jurisdiction in which the Property is located," i.e. Colorado law, govern. *Id*. at 6–7. The deed of trust also incorporates by reference the terms of the promissory note, including expressly identifying the high interest rate. *Id*. at 6.

On June 13, 2016 Bank of Lake assigned its rights under the promissory note and the deed of trust to WBL. *Id*. at 7. WBL is a non-bank entity registered as an LLC in New York with a principal place of business in New Jersey. *Id*. CMS defaulted on the promissory note by February 15, 2017. *Id*. at 8. On December 3, 2017 Yosemite sold its encumbered real property to Rent-Rite. *Id*. at 7. Rent-Rite knew about the default and received a purchase price discount based on the amount of debt secured by the property. *Id*. at 7–8. Yosemite and Rent-Rite have common management. *Id*. at 8.

Rent-Rite filed for Chapter 11 bankruptcy on December 11, 2017. *Id*. at 3. WBL filed a proof of claim in the bankruptcy proceedings, claiming an owed amount of $658,652.95 plus interest at the rate of 120.86% per year. *Id*. at 8–9. WBL asserted that the proof of claim was secured by the property. *Id*. at 9. The Bankruptcy Court noted that because Rent-Rite is not the

obligor on the promissory note, WBL's proof of claim sounded in rem in relation to the property. *Id*.

A few months later, Rent-Rite commenced adversary proceedings against WBL. *Id*. at 3. Rent-Rite asserted three causes of action: (1) declaratory judgment under Fed. R. Bankr. P. 7001(9); (2) claim disallowance under § 502 of the Bankruptcy Code; and (3) equitable subordination under § 510 of the Bankruptcy Code. *Id*. at 9. All three of Rent-Rite claims were premised on the theory that the interest rate in the promissory note is governed by Colorado law, and a 120.86% per year interest rate is usurious under Colorado law. ECF No. 7 at 4. WBL's answer asserted the following three affirmative defenses: (1) the parties to the promissory note agreed that Wisconsin law governed the interest rate; (2) Rent-Rite lacked standing to challenge the interest rate; and (3) Rent-Rite failed to join indispensable parties. ECF No. 6-1 at 14.

The parties agreed that the facts of the case were largely uncontested, and that the dispute was purely legal. Therefore, the parties filed a Joint Motion to Vacate Trial stating as such and requesting "a determination by the [Bankruptcy] Court on the legal principles at issue . . . without the need for trial." ECF No. 1-2 at 3. The parties proposed that they be permitted to submit stipulated facts, stipulated exhibits, and written closing arguments in lieu of trial. *Id*. The Bankruptcy Court granted the motion and received the parties' stipulations and written closing arguments. *Id*. at 3–4.

In its closing arguments, Rent-Rite asserted that the Bankruptcy Court must utilize Colorado conflict of law analysis, which applies Restatement § 187, under which the Wisconsin choice of law provision is unenforceable. *Id*. at 10. Alternatively, Rent-Rite argued that for choice-of-law purposes the Court should focus not on the promissory note but on the deed of trust, which is governed by Colorado law. *Id*. WBL responded that the Bankruptcy Court

should enforce the Wisconsin choice-of-law provision provided in the promissory note. Alternatively, if Colorado conflict of law analysis comes into play, WBL argued that it nevertheless also leads to Wisconsin substantive law. *Id*.

After reviewing the closing arguments the Bankruptcy Court "concluded that additional legal briefing was necessary." *Id*. at 11. The Bankruptcy Court raised issues that the parties had not themselves identified. ECF No. 7 at 7. Those issues included (1) whether the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C. § 1831d ("DIDA § 1831d") governs the interest rate and (2) if DIDA § 1831d applies, whether it federally preempts any of Rent-Rite's claims. *Id.*

In the requested supplemental briefing, Rent-Rite stuck with its original arguments: Colorado conflict of law analysis utilizes Restatement § 187, which leads to Colorado substantive law, under which the interest rate is invalid; and alternatively, the analysis should focus on the deed of trust. ECF No. 1-2 at 11. However, WBL modified its arguments in its supplemental brief. It argued that DIDA § 1831d does apply, and DIDA § 1831d dictates application of Wisconsin substantive law. *Id*. Further, even if DIDA § 1831d does not apply and Colorado choice of law is considered, the proper Colorado choice of law framework is Colorado's Uniform Commercial Code ("UCC"), which leads to Wisconsin substantive law. Alternatively, WBL proffers its original arguments that (1) the parties agreed to Wisconsin substantive law and (2) even if Restatement § 187 applies, it still leads to Wisconsin substantive law. *Id*.

On May 20, 2019 the Bankruptcy Court denied all of Rent-Rite's claims in favor of WBL. *Id.* at 45. The court found that DIDA § 1831d does apply; DIDA § 1831d dictates the application of Wisconsin law; and the interest rate is valid under Wisconsin law. The court

further found that even if DIDA § 1831d did not apply, federal choice-of-law principles also dictate application of Wisconsin law. For the sake of finality the court also conducted choice-of-law analyses pursuant to both Colorado statutory law under the Colorado UCC and Colorado common law under Restatement § 187. It found that both analyses also dictated application of Wisconsin law. Thus, no matter what choice-of-law analysis was correct, the Bankruptcy Court found that all roads led to Wisconsin substantive law.

Rent-Rite makes four arguments in the instant appeal. First, it argues that DIDA § 1831d cannot apply because the note was assigned to WBL, a non-bank. ECF No. 7 at 10. Second, it argues that WBL waived federal preemption as an argument by failing to plead it as an affirmative defense. *Id.* at 10–11. Third, it argues that the Bankruptcy Court should have focused its choice-of-law analysis on the deed of trust, not on the promissory note. *Id.* at 10. Fourth, it argues that the Bankruptcy Court improperly weighed the factors in the Colorado common law choice-of-law analysis. *Id.*

Two amici briefs were filed. The Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency filed an amicus brief in support of WBL. ECF No. 11. Professor Adam J. Levitin of Georgetown University Law Center filed an amicus brief in support of Rent-Rite. ECF No. 16. Both amici consider only whether DIDA § 1831d applies to non-banks upon assignment.

II. STANDARD OF REVIEW

This Court reviews the Bankruptcy Court's legal determinations de novo. *See In re Baldwin*, 593 F.3d 1155, 1159 (10th Cir. 2010). The Court also reviews de novo mixed questions of law and fact that primarily involve legal issues. *See In re Wes Dor Inc.*, 996 F.2d 237 (10th Cir. 1993). The Bankruptcy Court's factual findings are

reviewed for clear error. *See In re Johnson*, 477 B.R. 156, 168 (10th Cir. BAP 2012). If a "lower court's factual findings are premised on improper legal standards or on proper ones improperly applied, they are not entitled to the protection of the clearly erroneous standard but are subject to de novo review." *Id.*

III. ANALYSIS

A. Whether DIDA § 1831d Applies

DIDA § 1831d provides that state banks may charge interest "at the rate allowed by the laws of the State . . . where the bank is located." The parties do not dispute that the promissory note's interest rate was valid when made under DIDA § 1831d. Bank of Lake Mills was located in Wisconsin, and the parties agree that the interest rate is valid under Wisconsin substantive law. However, the parties dispute whether the promissory note's interest rate remained valid upon assignment to WBL, a non-bank entity. There exists no precedent directly addressing whether DIDA § 1831d extends to loans that have been assigned from state banks to non-bank entities. The parties' argument centers on two cases—*Meade v. Avant of Colorado, LLC*, 307 F. Supp. 3d 1134 (D. Colo. 2018), and *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015)—and on two common law rules—the valid-when-made rule and the stand-in-the-shoes rule.

Briefly, in *Meade* a District of Colorado court considered whether DIDA § 1831d completely preempted a state usury claim against a non-bank. *See* 307 F. Supp. 3d at 1142. It found in the negative, stating that "the cause of action provided by § 1831d(b) does not on its face apply to actions against non-banks." *Id.* at 1145. Although this language facially sounds compelling, *Meade* expressly notes that "[w]hether or not [§ 1831d] gives rise to a *defense* of preemption on the merits of Plaintiff's claims, it does not establish complete preemption or

permit *removal*," and it left that question to the state court on remand. *Id*. (emphasis in original). Indeed, the Tenth Circuit has distinguished complete preemption and defensive preemption. *See Schmeling v. NORDAM*, 97 F.3d 1336, 1339 (10th Cir. 1996) (describing complete preemption "not as a crude measure of the breadth of the preemption (in the ordinary sense) . . . , but rather as a description of the specific situation in which a federal law . . . substitutes a federal cause of action for the state cause of action, thereby manifesting Congress's intent to permit removal"). Thus, *Meade* is inconclusive for our purposes.

In *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), the Second Circuit considered whether § 85 of the National Bank Act ("NBA") defensively preempted state usury law when the collecting entity was a non-bank. The NBA is the mirror image of DIDA as applicable to federal banks, and federal courts routinely interpret and apply DIDA § 1831d in accordance with NBA §§ 85, 86. *See Mamot Feed Lot*, 539 F.3d at 902-03; *Discover Bank v. Vaden*, 489 F.3d 594, 604–06 (4th Cir. 2007) (noting that DIDA § 1831d "is to state-chartered banks" as the NBA "is to national banks"), *rev'd on other grounds* 129 S. Ct. 1262 (2009); *Stoorman*, 908 P.2d at 135 (giving the "same interpretation" to DIDA § 1831d and NBA § 85). Thus, the NBA "expressly permits national banks to 'charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located.'" *Madden*, 786 F.3d at 250 (quoting 12 U.S.C. § 85). The Second Circuit held that NBA § 85 did not apply to defensively preempt New York state usury law when the collecting entity was a non-bank. *See id.* at 249. It found that extending the NBA to non-bank entities "would create an end-run around usury laws." *Id.* at 251–52.

However, the Bankruptcy Court, WBL, and the FDIC variously assert that *Madden* was both incorrectly decided and irrelevant to the case at hand. First, the FDIC argues that *Madden*

incorrectly determined that no conflict existed between the state usury law and the NBA. ECF No. 11 at 23. The state usury law prohibited non-bank assignees from enforcing interest rates exceeding 25% per year. *See Madden*, 786 F.3d at 248. *Madden* found that the state usury law did not conflict with, and therefore could not be preempted by, the NBA because "applying state usury laws to the third-party debt buyers would [not] significantly interfere with [a] national bank's ability to exercise its powers under the NBA." *Id.* at 251. Rather, the ruling "'limit[s] . . . only activities of the third party which are otherwise subject to state control,' and which are not protected by federal banking law or subject to [Office of the Comptroller of the Currency] oversight." *Id.* (quoting *SPGGC, LLC v. Blumenthal*, 505 F.3d 183, 191 (2d Cir. 2007)). Yet the FDIC argues that prohibiting assignees from enforcing otherwise-usurious interest rates is in practice a prohibition on banks from assigning those interest rates, which ultimately conflicts with the NBA's provision that federal banks can charge interest rates as allowed by their respective home states.

Second, the FDIC explains that *Madden* is irrelevant anyway because the Second Circuit did not analyze the deciding factors in the instant case: the common law valid-when-made rule and the common law stand-in-the-shoes rule, both of which are applied by both Colorado and Wisconsin. Indeed, the Bankruptcy Court premised its decision that DIDA § 1831d extends to non-bank entities upon the valid-when-made rule. The Bankruptcy Court defined the valid-when-made rule as holding that if the interest rate in the original loan agreement was non-usurious, the loan cannot become usurious upon assignment. ECF No. 1-2 at 21. The Bankruptcy Court described the valid-when-made rule as "long-established," citing to several old Supreme Court cases and a handful of more recent Court of Appeals cases. *Id*. at 21–22. So long-standing, the Bankruptcy Court asserted, that it was inherently incorporated into both the

NBA and, later, the DIDA. *Id.* at 21. The FDIC further elaborates on this argument in its amicus brief. ECF No. 11 at 10–13.

Professor Levitin makes a compelling counterargument to the valid-when-made rule in his own amicus brief. He explains that the valid-when-made rule is a modern invention that could not have been incorporated into either the NBA or the DIDA. ECF No. 16 at 15–18. Alternatively, Professor Levitin requests that if I do apply the valid-when-made rule, I carve out an exception for loans intended for assignment from their inception. He cites to *Strike v. Trans-West Discount Corp.*, 92 Cal. App. 3d 735, 745 (Cal. Ct. App. 1979), which he describes as the only pre-DIDA case that has "anything remotely" to do with the valid-when-made rule as conceived by the Bankruptcy Court. In that case, a California state appellate court ruled that the California Constitution's exemption for banks from usury extended to assignees. *See id.* However, the court carved out an exception for loans intended for assignment from inception. *See id.*

Although I am convinced by Professor Levitin's academic analysis and by the Second Circuit's discussion, the Office of the Comptroller of the Currency ("OCC") in the U.S. Department of Treasury recently finalized a rule that upholds the valid-when-made rule in the instant context. *See Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred*, 85 Fed. Reg. 33,530, 33,530 (June 2, 2020) (to be codified at 12 C.F.R. pt. 7, 160). The rule clarifies that "when a bank transfers a loan, the interest permissible before the transfer continues to be permissible after the transfer." *Id.* The rule is expressly reactionary to "the legal uncertainty created by the *Madden* decision." *Id.* at 33,531. It was issued after the briefing and the decision by the Bankruptcy Court in this case.

The OCC cites the NBA as authority for this rule. *See Permissible Interest on Loans*, 85 Fed. Reg. at 33,531. As noted, the NBA and the DIDA are mirror images and are generally interpreted in accordance. *See Mamot Feed Lot*, 539 F.3d at 902-03. The rule explains that the NBA "clearly establishes that a national bank may (1) lend money, pursuant to a loan contract, with an interest term that is consistent with the laws of the state in which the bank is located and (2) subsequently transfer that loan and assign the loan contract." *Permissible Interest on Loans*, 85 Fed. Reg. at 33,531. Further, "[w]hen Congress enacted the NBA, it understood that loan transfers were a fundamental aspect of the business of banking and . . . the national banking system." *Id*.

The rule addresses commentator concerns that the valid-when-made rule "would facilitate predatory lending by promoting rent-a-charter relationships that allow nonbanks to evade state law." *Id.* at 33,534. It emphasizes the OCC's "strong position" against predatory lending and points to its guidance on how to manage risk related to third-party relationships. *See id*. The rule also refutes the argument that it "would undermine state interest caps" by noting that the valid-when-made rule affects only which state law applies; not whether state law applies. *See id*. However, the rule states that it "does not address which entity is the true lender" for predatory lending purposes. *Id.* at 33,535.

In accordance with this new OCC rule, I find that a promissory note with an interest rate that was valid when made under DIDA § 1831d remains valid upon assignment to a non-bank. But, as noted below, the new OCC rule introduces another issue that is relevant in this case: was the nonbank the "true lender" in this instance.

B. <u>Whether Preemption is an Affirmative Defense</u>

Rent-Rite argues that even if DIDA § 1831d does apply to loans assigned to non-banks, the Bankruptcy Court erred in even considering DIDA § 1831d because WBL failed to plead federal preemption as an affirmative defense. Here, the parties had agreed that the facts of the case were largely uncontested, agreed to forgo trial, and requested that the Bankruptcy Court rule on the remaining legal dispute. After receiving the parties' final briefs, the Bankruptcy Court decided that additional legal disputes required briefing—including whether DIDA § 1831d applied. Rent-Rite argues that it was error for the Bankruptcy Court to sua sponte raise federal preemption. ECF No. 7 at 15.

The Bankruptcy Court addressed this concern in its order, explaining that whether federal preemption constitutes an affirmative defense that must be pled is not settled within the Tenth Circuit. I tend to disagree with that conclusion. The Tenth Circuit held in *Cook v. Rockwell Int'l Corp.*, 790 F.3d 1088, 1092 (10th Cir. 2015), that "potential preemption defenses, like most other affirmative defenses, are forfeited if not made." Although the Bankruptcy Court is correct that *Cook* relies on the inapposite case of *Mauldin v. Worldcom, Inc.*, 263 F.3d 1205, 1211 (10th Cir. 2001) (finding that an argument had not been preserved for appeal because neither party had ever brought it up), that does not change *Cook*'s binding holding. In *Devon Energy Prod. Co., L.P. v. Mosaic Potash Carlsbad, Inc.*, 693 F.3d 1195, 1203 n.4 (10th Cir. 2012), the Tenth Circuit noted that "[o]rdinary preemption may be invoked in both state and federal court as an affirmative defense to the allegations in a plaintiff's complaint."

In this case, however, the parties asked the Bankruptcy Court to make a ruling on the law. The court reasonably concluded that it needed to have the DIDA issue briefed before rendering a decision. The purpose of requiring affirmative defenses to be pled is to "give the opposing party fair notice of the defense and the grounds upon which it rests." *Hayne v. Green Ford Sales, Inc.*,

263 F.R.D. 647, 649 (D. Kan. 2009). By requesting supplemental briefing on a new legal question, the Bankruptcy Court provided Rent-Rite notice and opportunity to address it. Holding otherwise would prevent courts from requesting additional briefing as necessary to resolve a case.

That being said, the Bankruptcy Court's request for supplemental briefing on DIDA § 1831d unknowingly (because the OCC rule had not yet issued) raised a new and material factual dispute: whether WBL was the "true lender" on the loan. If the true lender is a non-bank assignee, then DIDA § 1831d cannot attach. *See Fed. Deposit Ins. Corp. v. Lattimore Land Corp.*, 656 F.2d 139, 147 (5th Cir. 1981) (citing *Daniel v. First National Bank*, 227 F.2d 353 (5th Cir. 1955)) (noting an exception to NBA § 85 where "what was nominally a discount was either in fact a disguised loan by the bank or a usurious loan originally which the bank by its close association to the original transaction knew was flawed"). The OCC's new valid-when-made rule incorporates this principle, noting that it "does not address which entity is the true lender." *Permissible Interest on Loans*, 85 Fed. Reg. at 33,535.

The addition of a new factual dispute is relevant here because the parties agreed to forgo discovery and trial expressly based on their understanding that there were no relevant factual disputes. They agreed that only legal disputes remained, specifically: whether the choice-of-law provision in the promissory note governed; whether and how to apply Colorado conflict of law analysis; and whether the promissory note or the deed of trust was the governing instrument for choice-of-law purposes. Thus, the fact that Rent-Rite had notice of the federal preemption argument at the supplemental briefing stage is insufficient here because it did not give Rent-Rite opportunity to conduct discovery on the factual question of whether WBL was the true lender. Indeed, at oral argument Rent-Rite alleged that evidence exists in this case indicating that WBL

was the true lender who engaged in a rent-a-bank scheme with Bank of Lake Mills. For example, Rent-Rite noted the fact that a small Colorado lender obtained a subprime, high-interest loan from a Wisconsin community bank and the existence of alleged evidence that WBL was involved in negotiations over the original loan with CMS indicate that WBL may be the true lender.

C. Conclusion

I find that, per rule-based guidance from the OCC, a promissory note with an interest rate that was valid when made under DIDA § 1831d remains valid even upon assignment to a non-bank. However, DIDA § 1831d cannot apply to a promissory note with a nonbank true lender. Here, the parties did not have the opportunity to conduct discovery on the factual question of whether WBL was the true lender. As such, I reverse and remand to the Bankruptcy Court so that the parties can conduct discovery on whether WBL was the true lender, and the Bankruptcy Court can then make an appropriate finding on the issue.

ORDER

For the reasons described above, the May 20, 2019 Order of the Bankruptcy Court is REVERSED in part and REMANDED.

DATED this 12th day of August, 2020.

BY THE COURT:

R. Brooke Jackson
United States District Judge