# SPECIAL ALERT: SECOND CIRCUIT WILL NOT REHEAR *MADDEN* DECISION THAT THREATENS TO UPSET SECONDARY CREDIT MARKETS

Two months ago we issued a **Special Alert** regarding the decision of the Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC,*[1] which held that a nonbank entity taking assignment of debts originated by a national bank is not entitled to protection under the National Bank Act ("NBA") from state-law usury claims. We explained that the Second Circuit's reasoning in *Madden* ignored long-standing precedent upholding an assignee's right to charge and collect interest in accordance with an assigned credit contract that was valid when made. And, because the entire secondary market for credit relies on this Valid-When-Made Doctrine to enforce credit agreements pursuant to their terms, the decision potentially carries far-reaching ramifications for securitization vehicles, hedge funds, other purchasers of whole loans, including those who purchase loans originated by banks pursuant to private-label arrangements and other bank relationships, such as those common to marketplace lending industries and various types of on-line consumer credit.

After the decision, Midland Funding, the assignee of the loan at issue, petitioned the Second Circuit to rehear the case either by the panel or *en banc* – a petition that was broadly supported by banking and securities industry trade associations in *amicus* briefs. On August 12, the court denied that petition.[2]

## LIKELY REQUEST FOR SUPREME COURT REVIEW

We anticipate that Midland Funding will petition the US Supreme Court to issue a writ of certiorari to review the Second Circuit's decision. The Supreme Court is not required to review the case and, indeed, it accepts not much more than one percent of the cases it is asked to hear. In trying to persuade the Supreme Court that this case should be deemed among the exceptional few worth hearing, we expect Midland Funding to emphasize that *Madden* conflicts with the decisions in other circuit courts of appeal and, if this circuit split is not reconciled, unfairness and uncertainty due to the inconsistent application of law will result -- in this case with predictable disruption of credit markets.

In our view, Madden does conflict with decisions in both the Eighth and Fifth Circuits. In *Krispin* v. *May Department Stores Co.,* the Eighth Circuit addressed a similar fact pattern involving a national bank originated loans and then selling and assigning them to a nonbank retailer. The court held that the NBA preempted state-law usury claims against the store because courts should "look to the originating entity… and not the ongoing assignee…in determining whether the NBA applies."[3] In *FDIC* v. *Lattimore Land Corp.,* the Fifth Circuit likewise faced the common situation where the law governing the originator of the debt allowed a higher interest rate than the law governing the assignee. The court concluded that the

1 *Madden v. Midland Funding, LLC,* No. 14-2131-CV, 2015 WL 2435657, at *1, *8 (2d Cir. May 22, 2015).

2 Madden v. Midland Funding, LLC, No. 14-2131 (2d Cir. Aug. 12, 2015).

3 *Krispin v. May Department Stores Co.,* 218 F. 3d 919, 924 (8th Cir. 2000).

"non-usurious character of a note should not change when the note changes hands" and, hence, that the law applicable to the original creditor applied post-assignment.[4]

In short, we think the case merits the Supreme Court's attention, but we also recognize a petition for a writ of certiorari, given the odds, is always an uphill battle.

## IF THE SUPREME COURT TAKES A PASS

If the Supreme Court does not hear the appeal, the case will be remanded to the trial court to resolve a remaining choice-of-law question identified by the Second Circuit. Delaware was designated in the credit agreement as the governing law pursuant to a choice-of-law provision, but the borrower resides in New York and brought the usury-related claim under New York law. Needless to say, the trial court must determine whether Delaware or New York law applies without regard to NBA preemption, which the court ruled did not apply. In general, such determinations typically are fact specific, but for consumer-purpose credit of the type at issue in *Madden*, in the absence of preemption, courts have a tendency to prefer applying the consumer's home state law on public policy grounds even when there is a choice-of-law provision. If that is the case here, the plaintiff's usury-related claim will survive subject to any new defensive arguments Midland Funding advances.

## CONCLUSION

The Second Circuit's decision not to rehear *Madden* means that bank sellers of loans and related assets and non-bank assignees of bank-originated credit obligations probably will be contending with the effects of *Madden* on courts in the Second Circuit for years. While it is possible that the Supreme Court could review the decision, that outcome is far from certain. Additionally, new cases ultimately may present new opportunities for the Second Circuit to limit or distinguish *Madden*, if it is so inclined, but such a result necessarily would take time.[5]

It will also be interesting to see what reaction, if any, will come from the Office of the Comptroller of the Currency or the Federal Deposit Insurance Corporation given the potentially significant implications of *Madden* on the scope of federal preemption in the context of interest rate exportation by banks. To date, we understand that neither agency formally has expressed any views publicly on *Madden*.

Finally, in the short term, prudence dictates that all market participants should consider the risks that *Madden* poses to their business, investments and operations and whether there are risk mitigation measures that may be available.

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Questions regarding the matters discussed in this Alert may be directed to any of our lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

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[4] *FDIC v. Lattimore Land Corp.,* 656 F.2d 139, 148 (5th Cir. 1981).

[5] In this regard, complete arguments regarding the Valid-When-Made Doctrine, while briefed in connection with the petition for rehearing, appear not to have been presented to the Second Circuit in the initial appeal.

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