DREHER TOMKIES LLP ALERT

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AN UNFORTUNATE END: *MADDEN V. MIDLAND FUNDING SETTLES*

After eight years and a handful of court appeals, the parties in *In re Midland Funding, LLC Interest Rate Litigation* (formerly *Madden v. Midland Funding LLC*) have agreed to a settlement. The settlement must be approved by the New York district court.

We have written extensively on *Madden v. Midland Funding*, a case that got off course and never got back on track. To recap, the plaintiff alleged that a debt buyer violated the New York criminal usury law and the federal Fair Debt Collection Practices Act by charging and attempting to collect interest at a rate exceeding 25% on a debt originally arising from a credit card that was offered by a national bank located in a state without usury cap. The national bank sold the plaintiff's debt to a nonbank debt buyer who attempted to collect the debt. The plaintiff asserted that the debt buyer, as the assignee could not charge the same interest rate validly set by the national bank when the credit card account was opened.

The plaintiff appealed the case to the U.S Court of Appeals for the Second Circuit. The Second Circuit held that National Bank Act ("NBA") preemption did not apply to a nonbank debt buyer because (i) the debt buyer is neither a national bank, a subsidiary or agent of a national bank or acting on behalf of a national bank and (ii) the application of state usury law to debt buyers would not "significantly interfere" with the national bank's ability to exercise its powers under the NBA. Because of unfortunate dicta in the Second Circuit's opinion, some observers questioned whether the Second Circuit overturned the longstanding "valid when made" doctrine in its decision.

After a failed petition to the U.S. Supreme Court, the New York district court was left to make sense of the Second Circuit's ruling. The district court concluded that the New York criminal usury statute represents a "fundamental" public policy of New York and invalidated the Delaware choice-of-law provision in the cardholder agreements. We believe the district court identified the proper choice-of-law analysis but applied the analysis improperly under New York law to disregard the parties' Delaware choice-of-law. After finding that New York law applied, the district court denied the debt buyer's motion to dismiss and granted the plaintiff's motion for class certification without further analysis.

We still had hope at this point. In a future decision, the district court could have reaffirmed the predominance of the "valid when made" doctrine in New York by simply completing the usury analysis. As noted by the U.S. Solicitor General and the Office of the Comptroller of the Currency in their brief to the U.S. Supreme Court in this case, even if New York law applied, the debt buyer could prevail if New York usury law incorporates the "valid-when-made" doctrine. Historically, New York courts have recognized the "valid when made" doctrine.

Unfortunately, this settlement marks a lost opportunity for the New York district court to reaffirm the validity of the "valid when made" doctrine under New York law and to show how the doctrine should be properly applied in usury cases.

As part of the settlement, the debt buyer agrees to pay $550,000 in monetary relief, to reduce outstanding balances for class members by $9.25 million and to perform ongoing compliance with respect to the collection of interest from class members. Class members include New York residents that received a letter from the debt buyer attempting to collect interest at a rate greater than 25% per annum on a consumer debt and whose cardholder agreements purported to be governed by a state with no usury cap or to select no law other than New York law.

Future courts will be left to reaffirm the predominance of the "valid when made" doctrine in the Second Circuit's jurisdiction (NY, CT and VT). Guidance could come in the form of federal legislation. In February 2018, the U.S. House of Representatives passed the Protecting Consumers' Access to Credit Act (H.R. 3299), a bill that would codify the "validation when made" doctrine in federal banking statutes. The U.S. Senate has referred the bill to its Banking, Housing and Urban Affairs Committee. ❑

✧ *Elizabeth Anstaett and Susan Seaman*

Darrell L. Dreher
ddreher@dltlaw.com

Elizabeth L. Anstaett
eanstaett@dltlaw.com

Emily C. Cellier
ecellier@dltlaw.com

Susan L. Ostrander
sostrander@dltlaw.com

2750 HUNTINGTON CENTER
41 S. HIGH STREET
COLUMBUS, OHIO 43215
TELEPHONE: (614) 628-8000 FACSIMILE: (614) 628-1600
WWW.DLTLAW.COM

Michael C. Tomkies
mtomkies@dltlaw.com

Susan M. Seaman
sseaman@dltlaw.com

Lindsay P. Valentine
lvalentine@dltlaw.com

Judith M. Scheiderer
jscheiderer@dltlaw.com

Robin R. De Leo
robin@deher-la.com