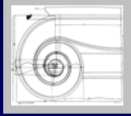

DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

August 14, 2015

PETITION FOR REHEARING DENIED IN *MADDEN V. MIDLAND FUNDING LLC*

On August 12, 2015, the United States Court of Appeals for the Second Circuit denied without explanation Midland Funding, LLC's and Midland Credit Management's petition for panel rehearing, or in the alternative, for rehearing *en banc*. *Madden v. Midland Funding LLC*, No. 14-2131 (2d Cir. Aug. 12, 2015) (order denying panel rehearing and rehearing en banc). In *Madden*, the Second Circuit held that the National Bank Act (NBA) did not preempt a consumer's state usury claims against a third-party nonbank assignee of a loan originated by a national bank.

The defendants made three arguments in support of their petition for rehearing. First, the defendants argued that the *Madden* decision misapplied fundamental principles of preemption under the NBA by failing to recognize the preemptive force of Section 85 of the NBA and adopting a rule that hollows out a national bank's fundamental power to set interest rates. According to the defendants, the decision ignores the fundamental principal of usury law that a contract is valid as long as it was valid when made. The decision also misapplied these principles when it eviscerated the "significant interference" test by concluding, without elaboration, that state regulation of banks' assignees will not significantly interfere with the banks' exercise of their powers. Notably, the *Madden* decision offered no support for the conclusion that state regulation of banks' assignees will not significantly interfere with the banks' exercise of their powers.

Second, the defendants argued that the *Madden* decision conflicts with the decisions of other court of appeal cases that hold that (i) the availability of preemption depends on the originator of the loan, consistent with the principles that a contract's validity is determined when it is made and (ii) regulation of the secondary market for a national-bank-issued loan constitutes the indirect regulation of the bank's ability to issue a loan with certain terms in the first place.

Third, the defendants argued that whether assignees of national banks are subject to state usury laws is a question of exceptional importance. The defendants claimed that if the *Madden* decision is allowed to stand, states will have the power to regulate key terms set by a national bank, on a loan it created, when that loan passes out of the bank's hands. A state law that could make the loan worthless in the hands of a purchaser will deeply impair the bank's ability to sell such a loan. In addition, the defendants claimed that the *Madden* decision could force banks (i) to alter the terms of their loans to satisfy individual state laws despite the authority granted in Section 85 of the NBA or (ii) not to rely on selling their loans altogether, which banks depend on to securitize their holdings and obtain liquidity for their operations.

Several groups, including the American Bankers Association, Independent Community Bankers of America, California Bankers Association, Utah Bankers Association, The Clearing House Association, Securities Industry and Financial Markets Association and Structured Finance Industry Group, Inc. filed *amicus* briefs in the case.

The Second Circuit's denial of the defendants' petition for rehearing does not necessarily mean that states have the power to regulate interest rates and other key terms set by national banks on loans that are assigned to nonbanks for a number of reasons. First, the *Madden* decision leaves room for the district court on remand to find that the defendants could charge the same rate that the originating national bank could charge pursuant to the common law valid-when-made doctrine regardless of whether the defendants themselves were entitled to NBA preemption. Second, the Second Circuit's decision is only binding in the Second Circuit, which encompasses Connecticut, New York and Vermont. Third, the decision could be appealed to and overruled by the United States Supreme Court. ❑

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