DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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SECOND CIRCUIT ISSUES MISGUIDED OPINION

The United States Court of Appeals for the Second Circuit has held that the National Bank Act does not preempt a consumer's claims against a debt buyer and its affiliated servicer for allegedly violating New York's usury law and the federal Fair Debt Collection Practices Act (FDCPA). *Madden v. Midland Funding LLC*, No. 14-2131-cv, 2015 WL 2435657 (2nd Cir. May 22, 2015).

The consumer did not pay and the holder bank sold the account to a non-bank debt buyer. The consumer lives in New York. The assignor national bank is located in Delaware and the amended credit card agreement provided that Delaware law applied.

The consumer filed a class action against the debt buyer and its servicer alleging that they violated the FDCPA and New York usury law by charging and attempting to collect interest at a rate exceeding New York's 25% per year criminal usury limit.

District Court Denies Defendants' Motion for Summary Judgment

The district court in denying the defendants' motion for summary judgment concluded that the National Bank Act would preempt any state law usury claim against the defendants. The district court supported its ruling by citing a string of cases where courts have held that one must look to the originating entity and not the ongoing assignee to determine whether National Bank Act preemption applies. *See, e.g., Krispin v. May Department Stores,* 218 F.3d 919 (8th Cir. 2000). The district court also cited cases supporting the common law "valid when made" doctrine which generally provides that a loan that is made at a lawful rate of interest cannot become usurious because of a subsequent assignment. *See Nichols v. Fearson,* 32 U.S. 103, 109 (1833); *FDIC v. Lattimore Land Corporation,* 656 F.2d 139, 148-49 (5th Cir. 1981).

Second Circuit Holds National Bank Act Preemption not Applicable to Defendants

On appeal, the Second Circuit held that National Bank Act preemption did not apply to the defendants because (i) neither defendant is 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 National Bank Act. According to the Second Circuit (without any apparent evidentiary finding), application of usury laws to debt buyers would not significantly interfere with the exercise of a national bank's power because such an application would not prevent a national bank from selling its debts even though such laws might decrease the amount that a national bank could charge for the debts in certain states. The Second Circuit also distinguished two Eighth Circuit Court of Appeals cases that indicated that the originating entity and not the ongoing assignee should be considered to determine whether National Bank Act preemption applies. *See Krispin v. May Department Stores*, 218 F.3d 919 (8th Cir. 2000); *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2005). The Second Circuit failed to consider the "valid when made" doctrine.

Issues on Remand

The defendants argued that even if the National Bank Act does not preempt state usury law with respect to non-bank assignees, the consumer had no viable claims because Delaware law applied and Delaware law permitted the interest rate charged by the defendants. The Second Circuit remanded the case for consideration of the Delaware choice of law in the agreement. The Second Circuit stated that it was not expressing an opinion as to whether Delaware law (which permits a bank to charge any interest rate allowable by contract, *see* Del. Code. Ann. tit. 5, § 943) would apply to the defendants as non-bank entities.

Why the Court Got it Wrong

We believe that the parties and the courts should not have focused on whether National Bank Act preemption applies to an assignee of a national bank, but rather should have focused on (i) whether the National Bank Act authorized the bank to charge interest at the rate agreed upon by the parties pursuant to Delaware law and (ii) whether the common law "valid when made" doctrine (not the National Bank Act) authorized the defendants to charge the agreed upon rate after the assignment. Federal preemption and Delaware law applied to the contract in the hands of the bank. When the contract was assigned by the bank, the assignee could then collect on the contract according to its terms, based on substantial state and federal case law precedents, including U.S. Supreme Court precedent. Thus, the debt buyer had every right to collect the debt with 27% interest regardless of whether or not National Bank Act preemption flows to an assignee.

Please contact us if you have any questions regarding the

Darrell L. Dreher
ddreher@dltlaw.com

Elizabeth L. Anstaett
eanstaett@dltlaw.com

Margaret M. Stolar
mstolar@dltlaw.com

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

Susan M. Manship
smanship@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

Charles V. Gall
cgall@dltlaw.com

Judith M. Scheiderer
jscheiderer@dltlaw.com

Susan L. Ostrander
sostrander@dltlaw.com

Emily C. Barlage
ebarlage@dltlaw.com

Madden decision or would like to discuss its effect on the collectability of interest accruing on bank loans that are assigned to debt buyers and other third parties.

✧ *Mike Tomkies, Charles Gall and Susan Manship*