Clients&FriendsMemo

# The Second Circuit Denies Midland's Request For Rehearing On Its Decision That Upended Longstanding Principles of Lending Law

**August 26, 2015**

On August 12, 2015, the United States Court of Appeals for the Second Circuit denied Midland Funding, LLC and Midland Credit Management (collectively, "***Midland***")'s petition for panel rehearing, or, in the alternative, rehearing *en banc*, of the Second Circuit's recent decision in *Madden v. Midland Funding, LLC* ("***Madden***"), 786 F.3d 246 (2d Cir. 2015), that upended well-settled lending law by holding that the federal preemption of state usury laws does not extend to non-national bank assignees of national banks, thus calling into doubt the enforceability of loans that were valid when made, depending on the identity and location of the assignee.[1] The Second Circuit denied Midland's petition despite longstanding precedent that recognized that a loan that was valid when made remains valid and enforceable upon assignment, including as to the rate of interest and regardless as to whom the loan was assigned.[2]

## Next Steps

Midland has 90 days from the Second Circuit's denial of rehearing to file a petition for a writ of certiorari to the Supreme Court seeking review of the Second Circuit's decision in *Madden*.[3] A petition for certiorari typically faces an uphill battle. The Supreme Court grants certiorari to less than 1% of the 10,000 petitions that it receives each year.[4] Should Midland petition the Supreme Court for relief, we expect Midland to repeat the arguments that it made in its request for rehearing, including its contention that *Madden* conflicts with decisions of other courts of appeals that hold that the National Bank Act precludes state regulation of a loan originated by a national bank, and

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1 Order Denying Rehearing, No. 14-2131-cv, ECF No. 140 (2d Cir. Aug. 12, 2015).

2 *See*, *e.g.*, *Krispin v. May Dep't Stores Co.*, 218 F.3d 919, 924 (8th Cir. 2000); *Phipps v. FDIC*, 417 F.3d 1006, 1013 (8th Cir. 2005); *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148-49 (5th Cir. Unit B Sept. 1981)).

3 Sup. Ct. R. 13.

4 *See* Supreme Court of the United States, Frequently Asked Questions (FAQ), http://www.supremecourt.gov/faq.aspx#faqgi9.

decisions of the Supreme Court that broadly protect a national bank's powers from state interference, including its prerogative to set interest rates.[5]

**The Implications**

As we previously explained, http://www.cadwalader.com/resources/clients-friends-memos/second-circuit-holds-application-of-state-usury-laws-to-third-party-debt-purchasers-not-preempted-by-national-bank-act, unless it is narrowed or overturned, the *Madden* decision may have dangerously far-reaching consequences and potentially chill the secondary credit markets by creating uncertainty with respect to the enforceability of bank- and thrift-originated loans that have subsequently been assigned to non-bank entities such as hedge funds, securitization vehicles, whole-loan purchasers, and other investors. Indeed, under *Madden*, the application of state usury laws may fundamentally alter the economic terms of assigned debt originated by a national bank by diminishing the amount of interest that can be collected upon assignment to a non-bank or voiding the assigned loans altogether.[6] In addition, in some states, state usury laws may subject assignees to criminal penalties for attempted enforcement of terms that were indisputably valid when made.[7]

Given the potentially harsh ramifications of *Madden*, national banks and their non-bank assignees should consider performing a review of loans that have been or may be offered for sale in the secondary market for compliance with state usury laws, including in particular arrangements that involve choice of law or venue clauses that reference states within the Second Circuit, which includes New York, Connecticut and Vermont.

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Please feel free to contact any of the following Cadwalader lawyers if you have any questions about this Clients & Friends Memo.


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[5] *See* Petition for Panel Rehearing and Rehearing En Banc by Defendants-Appellees, No. 14-2131-cv, ECF No. 96-1 (2d Cir. June 19, 2015).

[6] *See*, *e.g.*, N.Y. Gen. Oblig. Law § 5-511 (McKinney 2012 & Supp. 2015).

[7] *See*, *e.g.*, N.Y. Penal Law § 190.40 (McKinney 2010 & Supp. 2015).