Client Alert

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Madden vs. Midland Funding, LLC

In *Madden v. Midland Funding, LLC*,[1] the Second Circuit Court of Appeals held that federal law does not necessarily preempt state usury laws where a loan originated by a national bank is subsequently sold to a non-bank purchaser.

In the *Madden* case, a national bank originated a credit card account with the plaintiff cardholder, a New York state resident. In 2008, the national bank charged-off the cardholder's account and the receivables under the account. The receivables were then sold to the defendant, a debt collector, and the national bank retained no ownership of the account or the receivables.

In connection with collecting the debt, the debt collector notified the cardholder that interest was accruing on the debt at an annual rate of 27%. Although that rate of interest complied with the law of Delaware, the state in which the national bank was located and the receivables were originated, it could be considered a usurious rate under New York state law when applied to consumer debt. Because the Delaware-based originator of the receivables was a national bank, it relied on the National Bank Act in exercising its ability to apply an interest rate based on Delaware law, rather than the law of the New York, the cardholder's state.

In *Madden*, however, the Second Circuit found that, because the debt collector owned the receivable, rather than it being owned by a national bank or a subsidiary or agent of a national bank, and since the debt collector was not "otherwise acting on behalf of a national bank," New York's state usury laws were not preempted. The court found that "because application of the state law on which [the cardholder's] claim relies would not significantly interfere with any national bank's ability to exercise its powers under the [National Bank Act]," the National Bank Act provisions that permitted the national bank to lawfully charge interest to the cardholder residing in New York at a rate in excess of New York state's maximum interest rate did not apply to the defendant debt collector.

In reaching its decision, the Second Circuit used particularly broad language — i.e., whether the "application of state law to that action … significantly interfere[s] with a national bank's ability to exercise its power under the [National Bank Act]"[2] — in evaluating whether federal preemption was available. If this analysis is not limited or reversed, or is adopted by other courts, there may be negative effects on the loan sale market.

While the law in this area remains confused by the *Madden* decision, market participants may want to consider, in connection with sales or acquisition of loans on which they are relying on federal preemption to apply, whether any such loans with obligors in the states of New York, Connecticut or Vermont (the states encompassed by the Second Circuit) can or should be excluded.

[1] 786 F.3d 246 (2d Cir. 2015), *reh'g denied,* No. 14-2131 (2d Cir. Aug. 12, 2015).

[2] *Id*. at 250.

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