Client Alert

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The *Madden* Saga Continues: On Remand, *Madden* Survives Summary Judgment and District Court Certifies Class

By Oliver I. Ireland and Ryan J. Richardson

On February 27, 2017, the U.S. District Court for the Southern District of New York in part denied a renewed motion by Midland Funding, LLC ("Midland") to dispose of claims brought by Saliha Madden ("Madden") under the Fair Debt Collection Practices Act ("FDCPA") and the New York General Business Law ("NYGBL").[1] The Order also certified two classes of plaintiffs, thereby permitting Madden's claims to proceed as class actions.

Madden claims that Midland illegally charged Madden and other similarly situated New York debtors a usurious rate of interest on certain defaulted credit card obligations that Midland had purchased from a national bank. On May 22, 2015, the U.S. Court of Appeals for the Second Circuit reversed a June 2, 2014, order of the district court granting summary judgment in favor Midland and remanded the case. The Second Circuit held that Section 85 of the National Bank Act, 12 U.S.C. 85, which preempts state laws governing the interest a national bank may charge on a loan, does not apply after a national bank sells a loan to a non-bank.[2] The U.S. Supreme Court denied Midland's petition for writ of *certiorari* on June 27, 2016, leaving the district court to reconsider the litigation in light of the Second Circuit's holding.[3] In this alert, we briefly summarize the Order and examine certain open questions and potential next steps.

DISPOSITION OF MADDEN'S CLAIMS

The district court granted Midland's motion for summary judgment on Madden's claims for relief under New York's civil and criminal usury statutes. The district court reasoned that (i) the civil usury statute, which prohibits collection of interest in excess of 16%, does not apply to defaulted obligations; and (ii) the criminal usury statute, which provides that collection of interest in excess of 25% is a felony, does not provide a private right of action. *See* Order at 17-18.

The district court denied Midland's motion for summary judgment on Madden's claims (i) under the FDCPA based on Midland's attempt to collect interest on her debt at a rate of 27% annually, which exceeds New York criminal usury cap of 25%; and (ii) under the NYGBL based on Midland's representations that it was entitled to collect interest at the usurious rate. With respect to these claims, Midland argued that (1) the credit card account agreement governing Madden's debt obligation includes a choice of law clause favoring Delaware law, and, thus, the court should apply Delaware law to the dispute; and (2) even if New York law applies to the dispute, the New York criminal usury cap, like the New York civil usury cap, does not apply to defaulted obligations, such as the

[1] Order Granting in Part and Denying in Part Def.'s Mot. for Summary Judgment and Granting Plaintiff's Mot. for Class Certification, *Madden v. Midland Funding, LLC*, No. 7:11-CV-08149-CS (S.D.N.Y. Feb. 27, 2017) (hereafter, "Order").

[2] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

[3] *Midland Funding, LLC v. Madden*, 136 S.Ct. 2505 (2016).

defaulted credit card account of Madden's that Midland purchased from the issuing national bank. *See* Order at 18-24.

The district court rejected both of Midland's core arguments, concluding that (i) pursuant to New York's common law choice of law rule, the district court is compelled to apply New York law, not Delaware law, to the dispute, and (ii) the New York criminal usury cap of 25% applies to defaulted obligations.

1. *The New York Criminal Usury Cap Applies to Defaulted Obligations*

The district court acknowledged that both state and federal case law are not entirely clear regarding whether the criminal usury cap of 25% applies to defaulted obligations and that the issue "may ultimately have to be settled by the New York Court of Appeals," but the district court ultimately concluded that New York's criminal usury cap prevents a debt holder from collecting interest above 25%, even if such debt is in default. Order at 18.

2. *New York Law, Not Delaware Law, Applies to the Dispute*

New York's common law choice of law rule provides that a New York court will enforce a contractual choice of law, provided that (a) the state selected has a reasonable relationship to the agreement, and (b) the law chosen does not violate a fundamental public policy of New York. Order at 18. Although the choice of law clause in Madden's account agreement chose Delaware law, which has no usury cap, the court noted that, were it to enforce the choice of law clause and apply Delaware law to the dispute, the court would potentially sanction charging interest at a rate of 27% annually. The court went on to hold that such a rate would be prohibited under the New York criminal usury law, which constitutes a fundamental public policy of New York. Thus, the district court concluded that enforcing the choice of law clause in Madden's account agreement (i.e., applying Delaware law) would violate a fundamental public policy of New York. *See* Order at 24. Based on this finding, the district court declined to reach the question of whether Delaware has a reasonable relationship to the agreement. *See* Order at 20.

Midland also argued that New York's "rule of validation" provides a separate basis for enforcement of the choice of law provision favoring Delaware. The "rule of validation" provides that the court should assume the parties intend to enter into a valid contract and, as among the group of states that have a substantial relationship to the contract, apply the law of the state whose usury statute would sustain the contract in full or else impose the lightest penalty for usury. The district court rejected Midland's argument, reasoning that the rule of validation is intended to protect against the harsh remedy of forfeiture under the usury laws. The alleged violations of the FDCPA and NYGBL are remedied by civil penalties, not by forfeiture. As such, the court concluded that application of the rule of validation is not appropriate in this instance. *See* Order at 24-25.

CLASS CERTIFICATION

Following Madden's motion for class certification, the Order certifies two plaintiffs' classes:

1. *An Injunctive and Declaratory Relief Class* under Federal Rule of Civil Procedure 23(b)(2), comprising all persons residing in New York who were sent a letter by Midland attempting to collect interest in excess of 25% per annum regarding debts incurred for personal, family, or household purposes, whose cardholder agreements: (i) purport to be governed by the law of a state that, like Delaware's, provides for no usury cap; or (ii) select no law other than New York. This class covers only claims arising out of NYGBL violations from November 10, 2008, through the date of the Order (February 27, 2017).

2. *A Damages Class* under Federal Rule of Civil Procedure 23(b)(3), comprising all persons residing in New York who were sent a letter by Midland attempting to collect interest in excess of 25% per annum regarding debts incurred for personal, family, or household purposes, whose cardholder agreements: (i) purport to be governed by the law of a state that, like Delaware's, provides for no usury cap; or (ii) select no law other than New York. This class comprises two subclasses: (a) for claims arising out of NYGBL violations from November 10, 2008 through the date of the Order (February 27, 2017); and (b) for claims arising out of FDCPA violations from November 10, 2010, through the date of the Order (February 27, 2017). *See* Order at 25.

WHAT'S MISSING? WHAT'S NEXT?

The long-recognized, common law principle "valid when made," which provides that loan terms that are valid when made remain valid loan terms until they are satisfied or forgiven, irrespective of whether or to whom the loan is sold, was not discussed. As a result, the relationship between the conclusions memorialized in the Order and the "valid when made" principle is unclear.

The parties and the court will convene for a status conference on March 8, 2017, after which the court likely will issue a revised scheduling order.[4] Given that the court just recently certified the plaintiffs' classes, additional discovery may be necessary to determine the size of the class and, by extension, the scope of the alleged violations.

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[4] Notice of Court Conference, *Madden v. Midland Funding, LLC*, No. 7:11-CV-08149-CS (S.D.N.Y. Feb. 27, 2017).

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