

Supreme Court's Rejection Is Not the End of the Road for *Madden v. Midland Funding*



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REGARDLESS OF WHETHER OR NOT MIDLAND'S CASE IS SUCCESSFUL AT THE DISTRICT COURT, THERE ARE A NUMBER OF REASONS WHY THE SECOND CIRCUIT'S MADDEN DECISION IS NOT AS DISASTROUS AS SOME HAVE PORTRAYED IT TO BE.

On June 27, the U.S. Supreme Court rejected Midland Funding's petition for a writ of certiorari in *Madden v. Midland Funding*. The case now moves back to the U.S. District Court for the Southern District of New York, which will decide the two remaining claims regarding the contract's Delaware choice of law and whether state law incorporates the valid-when-made doctrine. A summary of the case (available at <http://www.pepperlaw.com/publications/valid-at-inception-rule-shot-down-by-the-second-circuit-2015-06-24/>) and recent updates (available at <http://www.pepperlaw.com/publications/the-solicitor-general-weighs-in-on-madden-v-midland-2016-05-25/>) are available.

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How the district court rules on the choice of law argument will play a significant part in whether the valid-when-made doctrine will apply. The account agreement in the *Madden* case contained a choice of law provision that designated the laws of the state of Delaware for the contract, and the court will consider this. This is important because, if Delaware applies the valid-when-made doctrine and the court were to decide that Delaware law governs, then the court could very well find in favor of Midland, regardless of the ruling on the federal law preemption issue by the U.S. Court of Appeals for the Second Circuit.

However, the district court could instead find that the Delaware choice of law clause in the contract is not valid because it would violate a “fundamental public policy” of the state of New York if enforced. If so, New York law would then govern the transaction, and the court might find that the interest rate charged was usurious under New York law. Even if the district court determines that New York law (rather than Delaware law) applies, however, Midland could still prevail if New York usury law incorporates the valid-when-made doctrine. As the Solicitor General said in its brief to the Supreme Court, “[t]he argument that New York law incorporates this principle would be a natural corollary to petitioners’ description of the valid-when-made rule as a ‘fundamental principle of usury law.’”

Regardless of whether or not Midland’s case is successful at the district court, there are a number of reasons why the Second Circuit’s *Madden* decision is not as disastrous as some have portrayed it to be.

First, the Second Circuit decision is only binding with respect to loans made in New York, Connecticut and Vermont. The risk of a negative decision from the Supreme Court, which would have been binding nationwide, is no longer an issue — at least not until a further appeal to the high court is taken down the road.

Second, while other circuits courts could adopt the reasoning of the Second Circuit in *Madden*, that is viewed as unlikely, given the well-reasoned brief by the Solicitor General opposing the decision. Additionally, two other circuits (the Fifth and the Eighth) have previously decided cases that strongly support the valid-when-made doctrine.

Third, marketplace lenders and other firms have restructured their legal relationships with their partner banks to distinguish themselves from the facts of the *Madden* case. For example, some lenders have appointed the bank as the master servicer, kept a greater

percentage of loans on the bank's balance sheets, and deferred compensation to banks until the borrower performs on the loans. They also have either curtailed lending in the three states impacted by *Madden* or have reduced rates in those states to mitigate any negative issues raised by the decision.

Fourth, in an effort to provide risk mitigation that is akin to a belt-and-suspenders approach, many lenders are also becoming licensed lenders in the states into which they are lending.

Finally, the Solicitor General's brief, reflecting the views of the Office of the Comptroller of the Currency, roundly criticized the Second Circuit decision and provided a roadmap as to the likely future arguments made in any future challenges to the *Madden* case in the Second Circuit.

A recently filed class action suit, *Bethune v. Lending Club*, No. 1:16-cv-02578-NRB (S.D.N.Y.), raises true lender and *Madden*-type issues and bears watching to see if the court issues any preliminary rulings that may bear on these topics. The Supreme Court denial of the writ of certiorari in *Madden* is certainly not good news, but the financial services industry generally, and the marketplace lending industry in particular, have had more than a year to deal with the fallout from the case and continue to find ways to mitigate the concerns it raises.