No. 15-610

IN THE

Supreme Court of the United States

MIDLAND FUNDING, LLC, and
MIDLAND CREDIT MANAGEMENT, INC.

Petitioners,

v.

SALIHA MADDEN

Respondent.

On Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit

RESPONDENT'S SUPPLEMENTAL BRIEF

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RESPONDENT'S SUPPLEMENTAL BRIEF

The government correctly recommends that certiorari be denied, noting the lack of a circuit split, the dubious importance of the decision below, and waiver issues that disqualify Midland from presenting key arguments. The government also does not endorse Midland's assertions that the securitization and sale of loans will halt if the ruling below stands—and rightly so. This case was decided more than a year ago, and there is no credible evidence that it has interfered with securitization, or indeed harmed banks at all.

The government's position on the merits, however, is incorrect. All parties agree that state usury law is preempted when its application significantly interferes with a bank's exercise of its powers. Midland waived that argument, and consequently the record contains no evidence of interference. The government nevertheless argues that the application of New York usury law to Midland's attempts to collect usurious interest is preempted by Section 85 of the NBA—which does not mention banks' assignees or the sale of loans at all, but instead merely gives national banks themselves the unusual power to charge interest to out-of-state borrowers without regard to the usury laws in other states. 12 U.S.C. § 85.

The government is trying to move the goalpost: it cannot show that the application of state usury law to Midland would limit banks' ability to charge interest, and so it seeks to redefine the Section 85 power broadly to include the ability to convey preemption rights. That redefinition finds no support in the statutory text. By allowing preemption even without a finding of significant interference, the government's argument end-runs the test that this Court recognized in *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996), which Congress codified at 12 U.S.C. § 25b(b), as well as this Court's decision in *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007). That end-run is unnecessary in light of the continuing availability of *Barnett Bank* preemption whenever significant interference actually occurs.

Even if the Court is sympathetic to the government's argument, the government's brief shows that Midland is asking, at best, for error correction in a case with vehicle problems and idiosyncratic facts. Truthfully, Midland is merely attempting to escape responsibility for its own overreaching vis-à-vis consumers and for its prior litigation mistakes. Certiorari should be denied.

I. The Decision Below Has Not Materially Affected Banks.

Although Midland continues to insist otherwise, there is no circuit split. Midland's principal assertion is that the question presented is "critical to the functioning of the national banking system and to the availability of consumer credit." Midland Supp. 2.

If such grand claims were true, the government would have echoed them—but it did not. Instead, the government notes that the "practical importance" of this case is uncertain because other factors, including state law rules, limit debt buyers' liability. U.S. Br. 20. Moreover, there is no evidence that the decision below has had any negative effect on the availability of consumer credit. In fact, credit card debt is approaching its all-time peak of $1.02 trillion as banks extend more credit to subprime borrowers. *See* Lucinda Shen, *Americans' Credit Card Debt Is Set to Hit $1 Trillion This Year*, Fortune (May 20, 2016), http://fortune.com/2016/05/20/americans-credit-card-debt-is-set-to-hit-1-trillion-this-year/.

Nor has the decision below "upended" any "'longstanding understanding' that preemption would apply in circumstances such as these." Midland Supp. 8. The Second Circuit's decision issued more than a year ago; it has been cited in only seven cases, five of which relate to NBA preemption. The only one of these that even arguably cites this case in a manner adverse to Midland is an unpublished district court decision addressing a tribal rent-a-bank scheme. *Pennsylvania v. Think Fin., Inc.*, No. 14-CV-7139, 2016 WL 183289, at *13 (E.D. Pa. Jan. 14, 2016). Far from evidencing Midland's prophesied sea change, these cases reveal the absurdity of Midland's alarmist rhetoric.

Although Midland and its amici predicted that the decision below would impair banks' ability to securitize debt, neither the government nor Midland's supplemental brief press that point—because it has not happened either.

Finally, Midland introduces an unpublished, not-peer-reviewed study suggesting that the decision has had an effect on "marketplace lending." Midland Supp. 5-6. As previously noted, however, marketplace lending bears no resemblance to credit card debt. *See* BIO 22-23. Moreover, the study authors acknowledge that they "cannot rule out that the effects we observe here are temporary market responses to *Madden*—rather than reflective of a new equilibrium in these markets." Colleen Honigsberg et al., The Effects of Usury Laws on Higher-Risk Borrowers 2 n.2 (May 13, 2016) <tinyurl.com/usurystudy>. Midland also overstates the study's findings. It ignores findings that borrowers are not strategically defaulting, and that prices for current loans have not changed. *Id*. at 2. It also omits that even before this case, loans to borrowers with low credit scores were rare and declining. *Id*. at 20 (Fig. 3). In sum, the effect of the Second Circuit's decision, even on marketplace lending, is far from clear.

In any event, this case is a poor vehicle to address marketplace lending. Regulators are currently considering bespoke marketplace lending regulations that will swamp any effect of this case. *See, e.g.*, Dep't of the Treasury, Public Input on Expanding Access to Credit Through Online Marketplace Lending, 80 Fed. Reg. 42866-01 (July 20, 2015). Moreover, the industry has already adapted to the decision below: banks are retaining an interest in marketplace loans rather than selling them to third parties, so that they can continue asserting NBA preemption. *See Lending Club's Enhanced Relationship with WebBank Comes into Focus*, Lexology (Mar. 9, 2016), http://www.lexology.com/library/detail.aspx?g=5bbee9ff-c33b-479b-a1d7-4fc040666e63. If marketplace lending is the concern, the Court can await a case involving it.

II. The Government's Merits Argument Is Unpersuasive.

The government argues that "a national bank's Section 85 authority to charge interest up to the maximum permitted by its home State encompasses the power to convey to an assignee the right to enforce the interest-rate term of the agreement." U.S. Br. 6. That is a radical extension of Section 85.

1. Before explaining why the government is wrong, it is important to emphasize what is not in dispute: Everybody agrees that state usury laws that interfere with a national bank's exercise of its powers are preempted. Thus, if a state law prevents a national bank from charging a rate of interest permitted by federal law, it is preempted. So too if a state law prevents a bank from selling a loan, or materially decreases the price that the bank could receive for that loan. What the parties dispute is whether Section 85 independently preempts the application of state usury law to non-bank assignees of bank debt *even if* there is no such effect on the banks themselves.

The case has focused on this narrow and unimportant issue because Midland affirmatively waived the argument that the application of New York usury law to it would significantly interfere with bank powers. Although Midland now argues that significant interference is "closely interrelated" with its Section 85 argument, Midland Supp. 10 n.3, its petition described the two issues as "distinct." Pet. 17. In the Second Circuit, Midland argued that it had "no burden whatsoever to show an interference with a national bank's exercise of powers" and dismissed the issue as a "red herring." C.A. Br. 23. Midland did not merely fail to present its arguments "elegantly," Midland Supp. 10; rather, Midland waived its best argument because it had no evidence to support it. That the argument was passed upon, and resolved against Midland, does not permit Midland to now rescind its waiver.

Consequently, if Section 85 does not itself grant third party assignees the right to evade state usury law, then Midland cannot prevail. But that does not mean that assignees in Midland's position cannot assert conflict preemption in future cases. Under the Second Circuit's rule, they can as long as they show significant interference with bank powers. If Midland and the government are correct that such interference is likely to occur, then this case will not pose any issue. Moreover, as the government notes, third parties may have other defenses under state law; none of those are at issue here.

2. Applying state usury law to debt buyers like Midland does not interfere with national banks' ability to charge the interest rates permitted by Section 85. This is obviously true: Bank of America and FIA charged rates above 25% while they held Madden's debt, and then sold the debt to Midland without any interference from state law. Going forward, the banks can continue to do so with other accounts. Because defaulted debt sells for so little, and almost never returns more than its face value, there is no evidence that forbidding Midland from charging interest above 25% on defaulted debt will reduce the price that the banks receive for their debt. BIO 18-19. In fact, the evidence disproves any such effect.

To evade this overwhelming case against conflict preemption, Midland and the government attempt to redefine the Section 85 right to include the power to convey preemption rights to a third party. But this redefinition has no basis in the statute: Section 85 never discusses assignments, assignees, or loan sales at all; to the contrary, it grants the special power to avoid state usury law *only* to national banks. As the Comptroller has explained, "[p]reemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself." *See* OCC News Release, Comptroller Calls Preemption a Major Advantage of National Bank Charter, NR 2002-10 (Feb. 12, 2002). "The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank." *Id*.

Indeed, Madden has been unable to locate any statute, regulation, interpretive letter, or prior amicus brief stating that a bank's Section 85 rights can be conveyed. Certainly, neither Midland nor the government has cited anything on point.[1] The absence of authority is telling because Section 85 and its predecessors have been on the books since 1864. It also belies the claim that there has been some

[1] The government cites *Planters' Bank of Mississippi v. Sharp*, 47 U.S. (6 How.) 301 (1848), decided fifteen years before the NBA was enacted. That case addressed whether the Contracts Clause protects the sale of loans, and did not discuss preemption.

longstanding rule extending Section 85 preemption to third parties.

The government recognizes that this supposed power to convey preemption is not "explicitly conferred on national banks by Section 85," but argues that it is implicit in the right to set rates because (1) banks have a right to sell the loans that they originate; and (2) it is a principle of usury law that if an interest rate term in a bank's original loan agreement is non-usurious, then the loan does not become usurious on assignment. U.S. Br. 7-8. Neither argument is persuasive.

Begin with the power to set interest rates. Section 85 singles out national banks for special treatment by granting them the unusual right to "take, receive, reserve, and charge" interest at the rates permitted by their home states, regardless of the law where the borrower resides. 12 U.S.C. § 85. But granting that special power to national banks does not implicitly grant it to anybody else. If anything, the appropriate inference is that by granting this power to national banks, Congress *denied* it to others. Consistent with that inference, Section 85 never mentions third parties, assignments, or sales.

OCC lending regulations confirm that the power to set interest rates does not include the power to convey preemption rights to others. The OCC provides that "[a] national bank may *make* non-real estate loans without regard to state law limitations concerning . . . [r]ates of interest." 12 C.F.R. § 7.4008(d)(10). The same regulation recognizes the banks' right to "sell, purchase, participate in, or otherwise deal in loans and interests on loans," but does not exempt such activities from state regulation. *Id*. § 7.4008(a). By articulating an exemption from state usury law for the *making* of loans, but not for the *sale* of loans, the OCC itself has recognized the distinction between the two. Similarly, the OCC's interest-rate regulation provides that a bank "may charge interest at the maximum rate permitted to any state-chartered or licensed lending institution by the law of that state," but says nothing about the bank's ability to transfer that right to others. *Id*. § 7.4001(b).

Every time this Court has interpreted Section 85, it has discussed only the power that the text actually grants: the power to set interest rates. *See, e.g.*, *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 9 (2003) (Section 85 "sets forth the substantive limits on the rates of interest that national banks may charge"); *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 301 (1978). To the extent the Court has elaborated, it has recognized that Section 85 preemption is appropriate because of "the special nature of federally chartered banks," again implying that the power cannot be conveyed to third parties who lack that special nature. *Anderson*, 539 U.S. at 10.

Similarly, in *Watters*, a divided Court extended NBA preemption to the wholly owned operating subsidiaries of national banks—but only because those entities were "tightly tied" to the banks, were authorized to "engage solely in activities that national banks are permitted to engage in directly," and were "subject to the same supervision and regulation as the parent bank." 550 U.S. at 15-20. Obviously, none of those characterizations apply to

Midland. Even that modest extension of preemption went too far: in Dodd-Frank, Congress effectively overruled *Watters* by withdrawing preemption for any affiliate or subsidiary that is not itself a national bank. 12 U.S.C. § 25b(e).

In flat contradiction of these authorities, Midland's position allows every third party that buys loans from a national bank to claim preemption. But banks are supervised by the OCC and are subject to a federal cause of action for usury under 12 U.S.C. § 86. Debt collectors are not subject to that federal oversight, and a broad preemption rule would substantially impair state oversight as well. The panoply of third parties that could evade regulation is frightening. As an illustration, the host of a popular late-night show recently spent $50 to incorporate a debt collection company and then created a rudimentary website—at which point he was offered the opportunity to purchase, and did purchase, $15 million in loans. *See* Last Week Tonight with John Oliver: Debt Buyers (HBO), YouTube, https://www.youtube.com/watch?v=hxUAntt1z2c (June 5, 2016). There is no reason to believe Congress intended this sham entity to have the same ability to invoke the Supremacy Clause as a national bank.

The government also does not seriously argue that denying preemption here will burden banks' ability to sell loans. Banks can freely sell loans to any eligible purchaser, including Midland—it is only the buyers' subsequent behavior that is affected by state usury law. The government argues that "in the aggregate, the marketability (and therefore the value) of a national bank's loan portfolio could be significantly diminished if the national bank could not transfer to assignees the right to charge the same rate of interest that the national bank itself could charge." U.S. Br. 9. This sentence is naked speculation (the word "could" does all the work), and it ignores the principal distinction between this case and others, *i.e.*, that this case involves only the sale of defaulted debt, for which, according to Midland's own submissions in discovery, the loss of ability to collect usurious interest does *not* affect the marketability, and therefore the value, of a loan portfolio. BIO 18-19. In any event, if the government's speculation is correct, third parties in future cases can prevail under *Barnett Bank*, and there is no need to adopt a sweeping interpretation of Section 85.

Against these points, the government principally relies on the "valid-when-made" rule, which provides that a non-usurious loan does not become usurious by virtue of a subsequent transaction. U.S. Br. 8. As the BIO explains (at 30-32), the cases the government cites hold only that when loans trade at a discount, the difference between the discount value and the face value does not become "interest" that might subject the assignee to usury liability—not that assignees can always charge the same rate of interest as assignors, even if the assignees are differently situated (*i.e.*, because they are not national banks with special favored status).

Moreover, the valid-when-made rule is a principle of contract law and a defense against usury claims, not a conferral of power on national banks—and so its existence says nothing about the scope of a bank's Section 85 powers. Indeed, Section 85 never even alludes to valid-when-made, and there is no other evidence that the statute incorporates it. To the contrary, in *National Bank v. Johnson*, 104 U.S. 271 (1881), this Court rejected the bank's effort to evade NBA usury liability, even though it had received a note that was valid when made. *See* BIO 31-32.

3. Finally, the views expressed in the government's brief receive no deference. Dodd-Frank requires the Comptroller to make any preemption determination personally by rule or order, on a case-by-case basis, supported by "substantial evidence." 12 U.S.C. § 25b(b)(3), (b)(6), (c). Such determinations, when properly made, still receive only *Skidmore* deference. *Id*. § 25b(b)(5)(A). These reforms were enacted precisely to prevent the OCC from issuing broad preemption determinations that harm consumers and abridge states' rights. The government's brief, however, does exactly that. It also eschews the statutory procedure: it is not a rule or order; the Comptroller did not sign it; and it does not cite evidence of interference. Moreover, the government's views are flatly inconsistent with the Comptroller's previous statements that national banks' preemption rights are inalienable. No deference is warranted.

CONCLUSION

Certiorari should be denied.

Respectfully submitted,

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