No. 15-610

In the Supreme Court of the United States

MIDLAND FUNDING, LLC, AND MIDLAND CREDIT MANAGEMENT, INC., PETITIONERS

v.

SALIHA MADDEN

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

SUPPLEMENTAL BRIEF FOR THE PETITIONERS

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Aside from its ultimate recommendation, the government's brief amply confirms the need for further review in this case. The government explains in detail why the Second Circuit's decision was profoundly incorrect. In addition, the government does not take issue with the broad implications of that decision—not surprisingly, given both the growing evidence of the decision's ongoing effects and the Second Circuit's jurisdiction over much of the American financial-services industry.

Where, as here, the government takes the position that the decision below was incorrect but nonetheless recommends a denial of certiorari, this Court routinely grants review. See, *e.g.*, *Gobeille* v. *Liberty Mutual Insurance*, 136 S. Ct. 936, 943 (2016); *Oneok, Inc.* v. *Learjet, Inc.*, 135 S. Ct. 1591, 1599 (2015); *Young* v. *United Parcel Service, Inc.*, 135 S. Ct. 1338, 1348 (2015); *POM Wonderful LLC* v. *Coca-Cola Co.*, 134 S. Ct. 2228, 2236 (2014); *Lawson* v. *FMR LLC*, 134 S. Ct. 1158, 1165 (2014); *American Trucking Associations, Inc.* v. *City of Los Angeles*, 133 S. Ct. 2096, 2101 (2013). The Court should do so again here. Particularly in light of the government's unambiguous position, this case would not be a close one on the merits. In addition, there can be no serious doubt that this case is sufficiently important to warrant one of the scarce spots on the Court's docket, because it presents a question that is critical to the functioning of the national banking system and to the availability of consumer credit. The petition for a writ of certiorari should therefore be granted.

1. The government does not mince words in confirming, as petitioners have argued, that "[t]he court of appeals' decision is incorrect" and "reflects a misunderstanding of Section 85 and of this Court's precedents." U.S. Br. 6.

As the government explains, a national bank's power to sell loans was an established "corollary of the power to originate loans" at the time of Section 85's enactment. U.S. Br. 7-8; see, *e.g.*, *Planters' Bank of Mississippi* v. *Sharp*, 47 U.S. (6 How.) 301, 321-325 (1848). Accordingly, "[a] national bank's power to charge the interest rate authorized by Section 85 includes the power to transfer a loan, including the agreed-upon interest-rate term, to an entity other than a national bank." U.S. Br. 7. Put dif-

ferently, the Section 85 power "carries with it" the power to assign loans to others. *Id.* at 8.

As the government additionally observes, applying state usury laws that prevent an assignee from "continu[ing] to charge that rate" would "significantly impair[]" the Section 85 power and run afoul of the "long-established 'valid-when-made' rule." U.S. Br. 8. Because respondent's state-law usury claim "directly interferes with a national bank's authority to make and transfer loans at the permitted rate of interest," it is "preempted by Section 85." *Id.* at 9. In so concluding, the government reaffirms that the Section 85 power "should be understood to incorporate the understandings that (a) sale of loans is an integral aspect of usual banking practice, and (b) a loan that was valid when made will not be rendered usurious by the transfer." *Id.* at 10. The government's reading of Section 85 thus matches petitioners' reading to a T.

The government further explains that, under *Barnett Bank of Marion County, N.A.* v. *Nelson*, 517 U.S. 25 (1996), there is an irreconcilable conflict between the National Bank Act and "any state law that would preclude [a national bank's] assignees from charging the full amount of interest that is permitted by the laws of [the bank's] home State." U.S. Br. 10. As the government points out, "nothing in the [National Bank Act] suggests that Congress intended to limit the national bank's [Section 85] power" by "authorizing States to regulate the terms on which loans originated by national banks could be assigned to other entities." *Ibid.* To the contrary, the government notes, Congress conferred additional powers on national banks, codified in 12 U.S.C. 24 (Seventh), that include the power to sell loans; those powers "reinforce[] the longstanding understanding that a national bank's Section 85 powers include the power to transfer

loans to other entities, which may continue to charge interest at the original rate." U.S. Br. 11. The government thus agrees with petitioners that application of state usury laws "would 'prevent or significantly interfere'" with the national bank's exercise of those powers and is preempted under *Barnett Bank* as well. *Ibid.* (quoting *Barnett Bank*, 517 U.S. at 33).

In explaining why respondent's claim is preempted, the government calls out three specific errors in the Second Circuit's reasoning. According to the government, the Second Circuit erred by "fail[ing] to recognize that a national bank's Section 85 power to charge certain interest rates carries with it the power to assign to others the right to charge the same rates." U.S. Br. 11. The Second Circuit also erred by attaching significance to the fact that the national bank assigned the debt "outright" and "retained no control over (or financial stake in) petitioners' efforts to collect th[e] debt." *Id.* at 12. And the Second Circuit erred still further by relying on an "unduly crabbed conception of [National Bank Act] preemption, and of implied-conflict preemption generally." *Id.* at 13. As the government notes, "[p]reemption in these circumstances does not require a showing that state usury law would reduce the price" a national bank could obtain for the assigned debt, let alone that the bank would be prevented from assigning the debt altogether. *Ibid.*; see *Parks* v. *MBNA America Bank, N.A.*, 278 P.3d 1193, 1204 (Cal.), cert. denied, 133 S. Ct. 653 (2012). Aside from the case caption, therefore, there is hardly any aspect of the Second Circuit's decision with which the government agrees.

2. Having thoroughly repudiated the Second Circuit's reasoning, the government does not contest the broad implications of the decision below. Indeed, the government expressly recognizes that state-law usury

claims, such as the one at issue here, "directly interfere[] with a national bank's authority to make and transfer loans at the permitted rate of interest." U.S. Br. 9. The government also warns 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." *Ibid.*

As petitioners have explained, the Second Circuit's decision has already begun to inflict severe consequences on secondary markets essential to the operation of the national banking system and to the availability of consumer credit. See Pet. 21-25; Reply Br. 4-8. If that decision is allowed to stand, a loan created by a national bank could become worthless once the loan is sold; seeking to collect on the loan could even become criminal. The effects of that decision are being acutely felt both by online marketplace lenders and by the credit market more generally.

Notably, since the parties' earlier briefing, a widely reported empirical study has eliminated any doubt about the ongoing consequences of the Second Circuit's decision. See Colleen Honigsberg et al., *The Effects of Usury Laws on Higher-Risk Borrowers* (May 13, 2016) <tinyurl.com/usurystudy> (Honigsberg). Using data from three marketplace-lending platforms, the authors of the study tested commentators' predictions that the Second Circuit's decision in this case would "significantly disrupt the secondary market for bank loans originated by national banks." *Id.* at 10 (citation omitted).

The authors concluded that the Second Circuit's decision is having a significant impact, especially on the volume of loans issued to higher-risk borrowers in the three States in the Second Circuit. While loan volume to the

highest-risk borrowers has increased by 124% in other jurisdictions since the Second Circuit's decision, it has fallen by 48% within the Second Circuit—despite the recency of the decision and the possibility of further review by this Court. See Honigsberg 20 & n.45. Remarkably, the authors found that loans to borrowers located within the Second Circuit with credit scores below 644 have "virtually disappeared." *Id.* at 21. Turning to the secondary markets in marketplace lending, the authors found "striking evidence" that market participants have applied a larger discount to higher risk, non-current loans that could be rendered usurious under the Second Circuit's decision. *Id.* at 25.

Taken together, the authors explained, those findings should "resolve any doubt that [the decision below] has, in fact, had a significant effect on consumer lending in the Second Circuit." Honigsberg 29. And the findings were all the more notable because, while the authors used the marketplace-lending context due to the accessibility of data, they noted that the Second Circuit's decision "may well have effects" on other markets that "dwarf marketplace lending activity in size and scope." *Id.* at 1 n.1.

Given the now-quantified impact of the Second Circuit's decision, it is no surprise that commenters responding to a request for information from the Treasury Department described the "regulatory uncertainty" surrounding the decision below as one of the "primary hurdles for growth" of the secondary markets in marketplace lending. Department of the Treasury, *Opportunities and Challenges in Online Marketplace Lending* 25 (May 10, 2016) <tinyurl.com/dotwhitepaper>. Indeed, since the parties' earlier briefing, a group of borrowers has filed a class action against a leading marketplace lender, invoking the Second Circuit's decision in alleging

that their interest rates exceeded the limits imposed by the New York usury laws. See Compl. at 4, 17-18, *Bethune* v. *LendingClub Corp.*, No. 16-2578 (S.D.N.Y. Apr. 6, 2016). Meanwhile, the chorus of commentators recognizing the implications of the Second Circuit's decision has only continued to grow. See, *e.g.*, David L. Beam et al., '*Madden' in the Supreme Court: Four Possible Outcomes*, Law360 (Apr. 25, 2016) <tinyurl.com/madden-law360>.

3. In recommending against certiorari, the government makes just two brief arguments. See U.S. Br. 13-20. Neither constitutes a valid justification for denying review—especially where, as here, the decision below is so clearly incorrect and has such widespread implications.

a. The government questions whether there is a circuit conflict on the question presented. See U.S. Br. 13-17. In particular, the government argues that the leading decision on the other side of the conflict—*Krispin* v. *May Department Stores Co.*, 218 F.3d 919 (8th Cir. 2000)—is distinguishable because the bank in that case was the "real party in interest," whereas the national bank in this case "sold respondent's debt outright" and retained no continuing right to the interest collected. U.S. Br. 16. The government's attempted distinction, however, is flatly inconsistent with its own view of the merits. A few pages earlier in its brief, the government describes as "misconceived" the Second Circuit's reliance on the fact that the national bank in this case "assigned respondent's debt outright" and retained no financial stake in the interest collected. *Id.* at 12. The government thus acknowledges the irrelevance of that fact to the preemption inquiry.

In any event, as petitioners have noted, the Eighth Circuit itself has declined to draw that distinction. It has

unambiguously read *Krispin* to stand for the broader proposition that, where a national bank has assigned a loan to another entity, "[c]ourts must look at 'the originating entity (the bank), and not the ongoing assignee * * *, in determining whether the [National Bank Act] applies.'" *Phipps* v. *FDIC*, 417 F.3d 1006, 1013 (2005) (quoting *Krispin*, 218 F.3d at 924).[1]

To the extent the government's real point is that the circuit conflict on the question presented is relatively shallow, that is hardly surprising. As the government itself acknowledges, the Second Circuit's erroneous decision upended the "longstanding understanding" that preemption would apply in circumstances such as these. U.S. Br. 11. And any concern about the shallowness of the conflict here is swamped by the sheer importance of the question presented and the fundamental errors in the Second Circuit's decision. In light of those considerations, the square conflict with the Eighth Circuit's decision in *Krispin* is more than sufficient to trigger this Court's review.[2]

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[1] While the government notes that the Fifth Circuit's decision in *FDIC* v. *Lattimore Land Corp.*, 656 F.2d 139 (Unit B Sept. 1981), involved a debt originated by a non-national-bank entity and then assigned to a national bank, rather than vice versa, see U.S. Br. 16, it correctly acknowledges that there is an "appealing symmetry," *id.* at 17, to the idea that the two situations should be governed by the same principle: namely, the principle, applied in the Fifth Circuit's decision, that "[t]he non-usurious character of a note should not change when the note changes hands." *Lattimore Land*, 656 F.2d at 148-149.

[2] Notably, in many of the cases set out above in which the government argued that the decision below was incorrect but recommended against certiorari, see p. 2, *supra*, this Court granted review even though the government argued that no conflict existed. See *Gobeille*, 136 S. Ct. at 943; *Oneok*, 135 S. Ct. at 1599; *POM Wonder-*

b. Finally, the government explicitly or implicitly rejects almost all of the laundry list of purported vehicle problems identified by respondent, including her claims that the Second Circuit's holding is limited to cases involving debt collectors or defaulted loans and that the Dodd-Frank Act somehow altered the landscape. See U.S. Br. 11 n.4 (stating that Congress "reaffirm[ed] the preemptive effect of Section 85" in the Dodd-Frank Act). The government offers only two reasons why this case may be an "unattractive" vehicle: the quality of the briefing below and the possibility that assignees will prevail under state law in this case and others. See *id.* at 17-20. Neither of those reasons is persuasive.

i. The government argues that the Second Circuit's "failure to recognize the full scope of powers granted to national banks [and] the potential significance of the valid-when-made rule"—which, incidentally, the district court fully appreciated, Pet. App. 26a-29a—"may be attributable at least in part to the lack of clarity in the briefing." U.S. Br. 19. Conspicuously, however, the government does not assert that any lack of clarity rose to the level of a waiver or forfeiture. Nor does the government dispute that the preemption issue was pressed or passed upon below. And with good reason: petitioners consistently argued that the National Bank Act continues to have preemptive effect after a national bank assigns a loan to another entity, invoking the Eighth Circuit's decisions in *Krispin* and *Phipps*, and the Second Circuit resolved that very question, basing its analysis on the *Barnett Bank* test. See Reply Br. 8-9. The government does not suggest that this Court's review would in

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ful, 134 S. Ct. at 2236; *Lawson*, 134 S. Ct. at 1165; *American Trucking Associations*, 133 S. Ct. at 2101.

any way be impaired by how the case was litigated below.[3]

The mere fact that petitioners could have more elegantly presented their arguments below is hardly a reason to deny review—and thus to allow an erroneous decision of such magnitude to stand. There is no reason to believe that the Second Circuit will revisit its decision in a future case. Not only is the Second Circuit notorious for rarely granting rehearing, but it denied rehearing in this very case (in the face of a substantial presentation from petitioners, represented by the same counsel as in this Court, and from the Nation's leading banking associations, appearing as amici at the rehearing stage as they have in this Court).

ii. The government correctly observes that the decision below is "interlocutory." See U.S. Br. 19. But given that this Court routinely reviews cases presenting preemption questions in precisely this posture, see Reply Br. 9, the government does not rely solely on the posture of the case. Instead, it argues not only that petitioners may still prevail in this case, but that defendants in other cases may also prevail where state law incorporates the valid-when-made principle. See U.S. Br. 19-20.

That is not a legitimate reason to deny review; if anything, it is a reason to grant it. The ability to invoke preemption does not turn on a head count of States that

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[3] To the extent that petitioners' briefing below did not more clearly label its preemption argument as either a Section 85 argument or a *Barnett Bank* argument, any lack of "precis[ion]" was understandable. See U.S. Br. 18. As the government's own merits argument demonstrates, the two theories are closely interrelated, with Section 85 defining a national bank's powers and *Barnett Bank* deeming preempted state laws that significantly interfere with the bank's powers under Section 85 or other provisions. See *id.* at 10-11.

would impose an adverse regime as a matter of state law; preemption protects its beneficiaries from being required to look to state law at all and potentially being subjected to a patchwork of inconsistent state regulations. See, *e.g.*, *Rowe* v. *New Hampshire Motor Transport Association*, 552 U.S. 364, 373 (2008). The government's suggestion that petitioners bear a burden to "demonstrate that state-law departures from the valid-when-made rule have been widespread," U.S. Br. 20, thus gets it exactly backwards. Especially in the context of the National Bank Act, the unpredictability and vagaries of state law render preemption essential, so as to ensure that state law has "no bearing whatever" on a bank's exercise of its federal authority. *Beneficial National Bank* v. *Anderson*, 539 U.S. 1, 10 (2003) (citation omitted).

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This is the rare case where resolving the question presented is as straightforward as it is important. The government's unqualified recognition that the Second Circuit's decision was incorrect only strengthens the case for further review. And the impact of the Second Circuit's decision on the national banking system and the availability of consumer credit can no longer seriously be disputed. Given the fundamental errors in the Second Circuit's approach, the significance of the question presented, and the circuit conflict on that question, this Court should grant the petition for certiorari.

Respectfully submitted.

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