Published on *The National Law Review* https://natlawreview.com

Cardholders Seek to Capital-ize on Madden

Article By:

Jonathan Watkins

Mark Chorazak

Aaron Lang

Last week, three Capital One cardholders filed a putative class action in the Eastern District of New York, *Cohen v. Capital One Funding, LLC*,[1] alleging that the rates of interest they paid to a securitization trust unlawfully exceed the sixteen percent threshold in New York's usury statutes. The Plaintiffs seek to recoup the allegedly excessive interest payments and an injunction to cap the interest rates going forward.

The Plaintiffs seek to leverage the Second Circuit's decision in *Madden v. Midland Funding, LLC*.[2] There are factual differences between the current lawsuit and *Madden*. In *Madden*, the loan in question was a nonperforming credit card account that Bank of America's Delaware-based credit card bank had assigned to Midland Funding, which sought to enforce the past-due loan. In *Cohen*, the loans involve credit card receivables from otherwise performing loans that have been deposited into securitization trusts. Another distinction is that *Cohen*, unlike *Madden*, is a putative class action. The legal theory in both cases, however, is the same: the Plaintiffs argue that the holders—here, securitization vehicles—do not have the originating national bank's right to collect interest at rates above the limits of New York's usury laws. And any usurious interest collected, the Plaintiffs argue, must be disgorged.

As we discussed in our prior C&F Memorandum, "It's a Mad, Mad, Madden World" (June 29, 2016), the Second Circuit's *Madden* ruling is unsound. Under the Second Circuit's *Madden* theory, the usury rate applicable to a given loan—and thus its enforceability—turns on the identity of the loan's holder. The notion that the enforceability of a loan originated by a national bank turns on who holds the loan from time-to-time conflicts with the well-settled valid-when-made doctrine—a doctrine that provides that whether a loan is usurious is determined at the loan's inception. This approach was abandoned in *Madden*. As a result, under *Madden*, bank-originated consumer loans can be less valuable if sold, thus devaluing the loans on the books of the originating bank. Banks, then, are discouraged from originating such loans or, once originated, from selling them. The net result is—at least in theory—a tightened consumer credit market.

In many corners, *Madden* is viewed to be "bad law." Even so, the Office of the Comptroller of the Currency recommended against petitioning the Supreme Court for a writ of certiorari in *Madden*. Nor did Congress produce a legislative fix, despite such a bill being introduced in 2018. Both the OCC and Congress faced political headwinds over the practice by some marketplace and payday lenders that originate high-rate consumer loans through banks under the so-called bank origination model; the concern was that reversing *Madden* could enshrine such practices and could be potentially harmful to consumers. (For a discussion of the bank origination model, see our prior C&F Memorandum, "Marketplace Lending Update: Who's My Lender?" (Mar. 14, 2018).) But that concern is not present in Cohen, where the Plaintiffs rely on *Madden* to attack traditional, currently performing credit card receivables that were originated by a national bank—a structure unrelated to the bank-origination model used by some marketplace lenders.

Cohen is the second *Madden*-related lawsuit brought against securitization trusts; the first is proceeding in Colorado against marketplace-lending receivables originated by Avant and Marlette. *See* "Marketplace Lending #5: The Very Long Arm of Colorado Law" (Apr. 24, 2019). Until *Madden* is reversed, we continue to recommend that clients exercise caution when acquiring, securitizing, or accepting as collateral consumer loans (or asset-backed securities backed by such loans), when the loans were originated to residents of a state in the Second Circuit (New York, Connecticut, and Vermont) and carry a rate above the applicable general usury rate (generally, sixteen percent in New York, twelve percent in Connecticut, and eighteen percent in Vermont).

1 No. 1:19-cv-03479-KAM-RLM (E.D.N.Y. filed June 12, 2019), https://www.cadwalader.com/uploads/media/CapitalOneCase.pdf.

2 786 F.3d 246 (2d Cir. 2015), *cert. denied*, __ U.S. __, 136 S. Ct. 2505, 195 L. Ed. 2d 839 (2016).

National Law Review, Volume IX, Number 170

Source URL:https://natlawreview.com/article/cardholders-seek-to-capital-ize-madden