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Parties Settle Midland Funding Interest Rate Litigation

Susan F. DiCicco and David I. Monteiro*

The authors of this article discuss a motion for preliminary approval of a settlement of the action in the Midland Funding *case. In 2015, the original ruling that nonbank assignees of a national bank did not get the benefit of National Bank Act "preemption" permitting lenders to charge any interest rate provided it does not exceed the rate permitted in the bank's home state stunned the financial community.*

When the U.S. Court of Appeals for the Second Circuit issued its decision in *Madden v. Midland Funding* in 2015, it sent shockwaves through the financial community for its unexpected ruling that nonbank assignees of a national bank did not get the benefit of National Bank Act "preemption" permitting lenders to charge any interest rate provided it does not exceed the rate permitted in the bank's home state.[1] After an unsuccessful attempt to get the U.S. Supreme Court to review the decision, the Second Circuit's decision remains binding precedent in federal courts sitting in New York, Connecticut, and Vermont. The case returned to the district court and has quietly been litigated over the last two years. On March 1, the final chapter began when the parties filed a motion for preliminary approval of a settlement of the action, as described below.

DECISION ON REMAND

On February 27, 2017, the district court issued an opinion addressing defendants' motion for summary judgment and plaintiff's motion for class certification. On the summary judgment motion, the court found that where, as in the *Madden* case, the debt was in default, the plaintiff/borrower may not assert violation of New York's civil usury statute as a defense, but she could assert violation of New York's criminal usury statute as a defense. The court also held plaintiff did not have an affirmative claim for usury and dismissed her

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[1] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016).

claims of civil and criminal usury, both of which formed the basis of her claim for relief that the debt was void and uncollectible. However, the court found that the violation of criminal usury law could be used as predicate fact in support of her claims under the Fair Debt Collection Practices Act ("FDCPA") and New York General Business Law Section 349 ("GBL") claims, both of which provide for statutory damages and actual damages.

Moreover, on the issue of which state's law applied, the court applied New York law, the law of the debtor's residence, rather than Delaware law, where the bank was located, because it found New York has a fundamental public policy to prevent criminal usury. As such, the court did not enforce the choice of Delaware law set forth in the cardholder agreement. The court also granted plaintiff's motion for class certification which, among other things, certified a "damages class comprising all persons residing in New York who were sent a letter by Defendants attempting to collect interest in excess of 25% per annum . . . whose cardholder agreements: (i) purport to be governed by the law of state that, like Delaware's, provides no usury cap; or (ii) selects no law other than New York." Based on statute of limitations requirements, the damages class was subdivided as all such persons who received such letters from November 10, 2008, to February 27, 2017, for the GBL claim and from November 10, 2010, to February 27, 2017, for the FDCPA claim. Thereafter, the original plaintiff stepped out of the case and several named plaintiffs continued with the case as the representative plaintiffs. The case was renamed *In re Midland Funding, LLC Interest Rate Litigation*.

THE PROPOSED SETTLEMENT

As set forth in the parties' motion for approval of the settlement, the settlement agreement features the following components:

- $9.25 million available for balance reduction relief credits for class members;
- $550,000 available for monetary relief to class members depending on their claim (amounts are divided among the subclass with FDCPA claims, the subclass with GBL claims, and a supplemental fund for those who paid interest in excess of 25 percent);
- Class members have the option to choose monetary relief or a reduction in their balance. However, if the full amount allowed for balance reduction is not exhausted, then all class members with a positive balance will receive a pro rata amount of the balance reduction even if they opted for monetary relief;
- A representation and warranty by Midland that it will comply with all

laws regarding interest including all binding precedent;

- The named plaintiffs have their balances reduced to zero in consideration of their efforts on behalf of the class; and
- Plaintiffs' counsel seeks $550,000 in attorneys' fees.

The parties reported to the court that there are 58,479 class members. Of those, only 7,842 class members paid interest in excess of 25 percent and the total amount paid in excess of 25 percent was $460,000. The parties also reported that based on certain assumed claim rates, the balance adjustment for class members submitting claims may be in the range of $1,920 and $5,250. Given that 60 percent of the class members have balances less than $5,000, the balance relief should eliminate the debt for many class members. On April 30, 2019, the court preliminarily approved the settlement and provided for notice to be sent to class members. The court scheduled a fairness hearing for final approval of the settlement for September 9, 2019.

KEY TAKEAWAYS

The settlement, if approved, brings the *Midland* case to a close after seven years. The settlement also means that Midland will not appeal the district court's decision not to enforce the choice of law provision on public policy grounds, and the plaintiffs will not challenge the court's decision that the borrowers may not assert affirmative claims of either civil or criminal usury under New York law. For the financial community, the legacy of the case will be the Second Circuit's 2015 decision, which remains binding precedent in federal courts sitting in New York, Connecticut, and Vermont, notwithstanding that the court did not consider the longstanding "valid when made" doctrine.