PIB LAW
Boston
Chicago
New Jersey
New York
Orange County
Philadelphia

THE PIB REPORT

Second Circuit Limits Citizenship of National Banks, and Reinforces the Aurora Decision

On June 29, 2016, the United States Court of Appeals for the Second Circuit held that a national bank is only a citizen of the state in which its main office is located, and not also of the state of the bank's principal place of business. Further, following the New York Court of Appeals' decision last year in *Aurora Loan Services, LLC v. Taylor*, the Second Circuit confirmed that proof of the possession of the note was sufficient to establish standing to foreclose, without the need to provide details pertaining the transfer or delivery of the note. *See OneWest Bank, N.A. v. Robert W. Melina, et al., Docket No. 15-3063.*

By way of background, defendant-appellant Robert W. Melina obtained a Note from Wall Street Mortgage Bankers Ltd. in the amount of $591,000.00, secured by a mortgage for his property in Brooklyn, New York. The Note was endorsed to IndyMac Bank, F.S.B., who later indorsed the Note in bank. In July 2008, the Office of Thrift Supervision ("OTS") closed IndyMac and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver. The OTS also created a new entity, IndyMac Federal Bank, F.S.B. ("IndyMac Federal"), transferred IndyMac's assets to IndyMac Federal, and appointed the FDIC as IndyMac Federal's conservator. The FDIC also later became the receiver for IndyMac Federal. In March 2009, the FDIC entered into a Loan Sale Agreement ("LSA") to sell nearly all of IndyMac Federal's assets to plaintiff-appellee OneWest Bank, N.A. ("OneWest"). In August 2009, defendant defaulted on the loan, and in September 2014, OneWest brought a foreclosure action in the United States District Court for the

Practice Areas

- Mortgage Banking
- Bankruptcy
- Reinsurance / Insurance
- Repurchase Solutions / Mortgage Fraud
- Consumer Finance
- Fair Lending
- Commercial Litigation
- Corporate Matters
- Regulatory & Supervisory Matters
- General Counsel
- Securities Litigation
- Design Professionals
- Intellectual Property

To read more, click here.

Eastern District of New York, based upon the court's diversity jurisdiction. The district court granted OneWest's motion for summary judgment and denied defendant's cross-motion to dismiss. Defendant timely appealed.

On appeal, the Second Circuit held that, for purposes of diversity jurisdiction, the district court correctly concluded that a national bank is only a citizen only of the state in which its main office is located, and not also of the state of its principal place of business. The Second Circuit cited 28 U.S.C. § 1348, which provides that national banks shall "be citizens of the States in which they are respectively located." The Second Circuit also noted that the United States Supreme Court has "unequivocally" held that, for diversity purposes, a national bank is "located" in the state designated in its articles of association as the locus of its main office - and not in every state in which it has branch offices. *See Wachovia Bank v. Schmidt*, 546 U.S. 303, 307 (2006). *Wachovia*, however, left open the issue of whether a national bank is also a citizen of the state of its principal place of business. The Second Circuit adopted the decisions of other federal courts of appeals and found that a national bank is only a citizen of the state listed as its main office in its articles of incorporation. Therefore, the Second Circuit concluded, diversity jurisdiction existed because OneWest's principal place of business is, as with its main office, in California.

Additionally, the Second Circuit affirmed that OneWest had standing to foreclose on defendant's mortgage. The Second Circuit rejected defendant's argument that OneWest failed to provide the exact date the Note was transferred, or any details at all regarding the delivery of the Note prior to commencement of the foreclosure action. The Second Circuit cited *Aurora Loan Services, LLC v. Taylor*, which held that "[a]lthough the better practice would have been for the plaintiff to state how it came into possession of the note in its affidavit in order to clarify the situation completely," the plaintiff was not precluded from obtaining summary judgment by not having provided these details. 25 N.Y.3d 355, 362 (2015). The Second Circuit also found that OneWest was the also the assignee of defendant's loan, on the grounds that the LSA assigned to OneWest all of the FDIC's previous rights to defendant's loan as the conservator and receiver of IndyMac Federal.

Willful Infringement Standard Relaxed by the Supreme Court

On June 13, 2016, in a unanimous decision in *Halo Electronics, Inc. v. Pulse Electronics, Inc.*, the United States Supreme Court relaxed the standard for determining willful infringement and entitlement to enhanced damages in patent cases. Because enhanced damages awards of "up to three times the amount found or assessed" may now be easier for patent owners to obtain (under 35 U.S.C. § 284), this decision is likely to have a significant impact on patent cases going forward.

The previous standard for enhanced damages was the two-part test for willful infringement articulated by the Federal Circuit nine years ago in *In re Seagate*, 497 F. 3d 1360 (2007) (*en banc)*. *Seagate* required a patent owner to first "show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent." If, and only if, that so-called "objective recklessness prong" was satisfied, the next step was the "subjective prong," which determined whether the risk of infringement "was either known or so obvious that it should have been known to the accused infringer." Like the objective prong, the subjective prong also had to be proven by clear and convincing evidence, and only if both prongs were satisfied, could the Court decide whether to "increase the damages up to three times the amount found or assessed," under Section 284.

And *Seagate* went even further, holding that "objective recklessness" was not present if the accused infringer "raised a 'substantial question' as to the validity or noninfringement of a patent," even if the accused infringer was unaware of those defenses when he or she infringed. In other words, if the accused infringer raised reasonable defenses as to invalidity or noninfringement at trial - months or years after the infringement began - the Court could find that there was no willful infringement and no possibility of enhanced damages.

Applying the *Seagate* standard, the *Halo* jury found that Pulse willfully infringed Halo's patents, but the Court declined to enhance damages under Section 284 because Pulse had presented at trial a defense that was not "objectively baseless." As such, the District Court held that Halo had failed to satisfy the "objective recklessness" prong. The Federal Circuit affirmed the District Court's decision, and the Supreme Court granted certiorari, vacated and remanded.

In rejecting the strict *Seagate* standard for willful infringement and enhanced damages, the Supreme Court explained that enhanced damages "are as old as U.S. Patent law." In fact, the Patent Act of 1793 mandated treble damages for acts of infringement, and it was not until the Patent Act of 1836 that such damages became discretionary (thereby protecting "a defendant who acted in ignorance or good faith"). Thereafter, in 1952, Congress enacted Section 284, providing that "punitive or 'increased' damages" could be recovered in cases of willful infringement.

The Supreme Court held that *Seagate* was inconsistent with Section 284, unduly rigid, and impermissibly encumbered the statutory grant of discretion to district courts to award enhanced damages. The Supreme Court further stated that the Seagate test "excludes from discretionary punishment many of the most culpable offenders, including the 'wanton and malicious pirate' who intentionally infringes a patent." In the context of such deliberate wrongdoing, the Court stated that "it is not clear why an independent showing of objective recklessness should be a prerequisite to enhanced damages." Instead, according to the Supreme Court, enhanced damages awards are "designed as a sanction for egregious infringement behavior."

The Supreme Court also held that a clear and convincing evidence standard was improper, at least because Section 284 does not impose a specific evidentiary burden. Thus, the Supreme Court held that preponderance of the evidence was the proper standard.

The *Halo* decision is consistent with the Supreme Court's prior decision in *Octane Fitness, LLC v ICON Health & Fitness*, 134 S. Ct. 1749 (2014). In *Octane Fitness*, the Supreme Court relaxed the standard for awarding attorneys' fees in patent cases, under 35 U.S.C. § 285, and eliminated a two-part test for determining whether a case was exceptional. As in *Halo*, *Octane Fitness* also changed the evidence standard from clear and convincing evidence to a preponderance of the evidence.

The new "egregious misconduct" standard for enhanced damages articulated in *Halo* will be further interpreted by the Courts in future decisions. But for now, patent owners may find enhanced damages awards easier to obtain because an accused infringer will not be insulated from such awards by simply raising a substantial question as to validity or non-infringement at trial. On the other hand, patent owners could return to the practice of sending out demand letters to potential defendants seeking licensing fees, and could use the resulting knowledge of their patent rights to prove willful infringement in any subsequent patent action. In any event, the *Halo* decision is likely to have a significant impact on future patent infringement cases.