Special Alert: More Turbulence for Marketplace Lending – CFPB Prevails in "True Lender" Litigation

After what seems to be an extended season of heavy weather for marketplace lending, a federal district court in California unleashed a late-Summer lightning storm in *Consumer Financial Protection Bureau v. CashCall, Inc.* In a CFPB action leveled against the so-called "tribal model" of online lending, the court held that defendants, CashCall and its affiliated entities and owner, engaged in deceptive practices by collecting on loans that exceeded the usury limits in various states. Although the case focused on the tribal model – a structure where the loan is made by an entity located on tribal land and subsequently transferred to an assignee not affiliated with the tribe – the court's opinion raises critical issues about the extent to which its analysis applies to the more common "bank partnership model" of marketplace lending.

"TRUE LENDER" TEST

As we have seen in some but not all similar cases, in order to determine whether the governing law clause in the loan agreement at issue, which recited the applicability of tribal law, was to be enforced, the court engaged in an extended "true lender" analysis based on a "totality of the circumstances" test. The court concluded that CashCall, not the tribal actor, a now-defunct entity named Western Sky Financial, was the *de facto* lender. Facts critical to that conclusion included:

- Loans were funded by a reserve account continuously replenished by CashCall
- CashCall purchased all the loans
- CashCall assumed all economic risks and benefits of the loans
- CashCall took assignment of the loans before the consumer's first payment was due
- CashCall assumed all regulatory risk through a broad indemnity
- CashCall guaranteed Western Sky a minimum monthly fee

Based on its determination that CashCall was the true lender considering the totality of the circumstances, the court further concluded that tribal law, as specified in the governing law clause of the loan agreement, had no "substantial relationship" to the parties or the transaction. Likewise, the court held that the contractual choice of law should not be enforced because application of tribal law would violate the "fundamental public policy" of the states where the consumers reside – states with a "materially greater interest . . . in the determination of the particular issue and which . . . would be the state of applicable law in the absence of an effective choice of law by the parties."

DECEPTION

Having addressed the governing law issue in this manner, and deeming state usury laws applicable, the court turned to the question of whether CashCall's loan servicing and collection practices were deceptive under the Consumer Financial Protection Act (CFPA). The court found that those practices did create a false "net impression to consumers that the loans were enforceable and that borrowers were obligated to repay the loans in accordance with the terms of their loan agreements." This, in the court's view, satisfied the federal deception standard notwithstanding the fact that the CFPB's allegations were hinged solely on violations of state usury law, the application of which rendered the loans unenforceable in whole or part. The court likewise concluded that the CFPB's case was not impaired by its statutory inability to establish a federal usury limit.

PERSONAL LIABILITY

The court held that CashCall's sole owner and president, along with the company itself, also was personally liable for the violations at issue because he (a) participated directly in the deceptive acts or had authority to control them and (b) had knowledge of the misrepresentations or was recklessly indifferent to any wrongdoing. The court reached this conclusion about personal liability under the CFPA despite evidence that CashCall and its owner relied on written opinions from a law firm. In so doing, the court accepted the CFPB's position that the CFPA contains no reliance on advice of counsel or mistake-of-law defense to civil liability.

IMPLICATIONS FOR BANK PARTNERSHIP MODEL

The specific tribal model program at issue in the case has been defunct for some time, although the outstanding loans continued to be serviced. In general, the tribal model remains less significant in the market than the more common bank partnership model. We offer some preliminary thoughts about the implications of *CFPB v. CashCall* to the bank partnership model.

As discussed above, the court relied on the "totality of the circumstances" test to determine the true or *de facto* lender - a test that not all courts apply. Courts that do sometimes give far greater weight to certain test factors in a manner that would be expected to result in a more favorable assessment of typical bank partnership structures. Even applying the test as this court did, however, the bank partnership model implicates important factual and legal distinctions.

For example, unlike the tribal lender in this case, banks typically self-fund the loans and the market has been moving towards bank retention of some credit risk. Likewise, loan originations by banks and subsequent assignments implicate federal law and raise preemption issues in ways that loans by tribal lenders do not. For example, the National Bank Act lists as an express power of national banks the ability to sell loans, and a bank's interest rate exportation authority to charge interest up to the maximum permitted by its home state encompasses a federal law right to convey to an assignee the right to enforce the interest rate term of the loan agreement.

This is not to say – particularly in a season where the bank partnership model increasingly seems to be a lightning rod for legal challenges – that *CFPB v. CashCall* holds no lessons for more common marketplace lending structures. With this victory in hand, and a pending suit challenging an off-shore model of online lending, it will also be interesting to see what role the CFPB will play in the bank partnership model debate.

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Questions regarding the matters discussed in this Alert may be directed to any of our lawyers listed below, or to any other BuckleySandler attorney with whom you have consulted in the past.

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