Nos. 18-55407, 18-55479

IN THE

United States Court of Appeals for the Ninth Circuit

CONSUMER FINANCIAL PROTECTION BUREAU,
Plaintiff-Appellant / Cross-Appellee,
v.

CASHCALL, INC., WS FUNDING, LLC, DELBERT SERVICES CORPORATION, AND J. PAUL REDDAM,
Defendants-Appellees / Cross-Appellants.

On Appeal from the United States District Court
for the Central District of California
Case No. 2:15-cv-07522-JFW-RAO, Hon. John F. Walter

MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE THE INNOVATIVE LENDING PLATFORM ASSOCIATION IN SUPPORT OF NEITHER PARTY

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October 26, 2018

Pursuant to Federal Rule of Appellate Procedure 29(a)(3), the Innovative Lending Platform Association ("ILPA") respectfully moves this Court for leave to file an amicus curiae brief in support of neither party.

1. The Innovative Lending Platform Association (ILPA) is the leading trade organization representing online lending and service companies that serve small businesses, and the leading voice urging clear and sensible regulation of the online commercial lending industry. *See* http://innovativelending.org. The ILPA's membership[1] shares a commitment to the health and success of our nation's small businesses and is dedicated to advancing best practices and clear standards that support responsible innovation and access to capital for small businesses. The ILPA and its members thus have deep background in the online lending industry, and a keen interest in the interpretations of long-standing legal principles affecting that industry and its customers.

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[1] ILPA's members are 6th Avenue Capital, BlueVine, Breakout Capital, Fundbox, Kabbage, Lendio, OnDeck, Orion First, The Business Backer, and PayNet.

2. The ILPA's amicus brief provides the Court with useful industry perspective on the dominant legal frameworks underlying the online commercial lending industry. It also addresses two central issues presented in the appeal: (a) the concept of identifying a "true lender" different from the lender specified in a loan agreement; and (b) the enforceability of contractual choice-of-law provisions. As the amicus brief explains, this Court's treatment and discussion of both could have far-reaching, unintended consequences beyond the particular facts of this case for the online lending industry and for the consumers and small businesses it serves. The ILPA respectfully submits this brief to offer background and industry perspective on these principles.

3. Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(E), counsel for amicus curiae states that no counsel for the parties named in this case has authored the brief in whole or in part; no party or counsel for the parties named in this case has contributed money that was intended to fund preparing or submitting the brief; and no person—other than the amicus curiae, its members, and its counsel—contributed money that was intended to fund preparing or submitting the brief.

4. Pursuant to Ninth Circuit Rule 29-3, the undersigned counsel has contacted counsel of record for the parties to seek consent to the filing of the amicus brief. Counsel for each party has indicated that it takes no position on the filing of the amicus brief at this time.

For the above reasons, ILPA respectfully asks this Court to grant leave to file the accompanying brief of amicus curiae.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This motion complies with the length limits permitted by Ninth Circuit Rule 27-1 and Fed. R. App. P. 27(d). The motion is 422 words, excluding the portions exempted by Fed. R. App. P. 27(a)(2)(B) and 32(f).

This motion's type size and type face comply with Fed. R. App. P. 32(a)(5) and (6), because the motion has been prepared in a proportionally spaced typeface using Microsoft Word 2013 in Century Schoolbook 14-point font.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 26, 2018.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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IDENTITY AND INTERESTS OF AMICUS CURIAE

The Innovative Lending Platform Association (ILPA) is the leading trade organization representing online lending and service companies that serve small businesses. *See* http://innovativelending.org. The ILPA's membership[1] shares a commitment to the health and success of our nation's small businesses and is dedicated to advancing best practices and clear standards that support responsible innovation and access to capital for small businesses.

A tangible example of the ILPA's leadership is the SMART Box™ model disclosure initiative—short for "Straightforward Metrics Around Rate and Total cost." *See* http://innovativelending.org/smart-box. Developed by the ILPA with input from other lending platforms, trade associations, policymakers, non-profit organizations, small business advocates, and small business owners, the SMART Box is an industry-first model pricing disclosure that empowers small businesses to understand and assess their financing options. Rather than bury the key financial terms in jargon or boilerplate, the SMART Box disclosure

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[1] ILPA's members are 6th Avenue Capital, BlueVine, Breakout Capital, Fundbox, Kabbage, Lendio, OnDeck, Orion First, The Business Backer, and PayNet.

puts them front-and-center and in plain English to ensure small business applicants can make informed borrowing decisions. The SMART Box prominently provides a small business borrower with five critical pricing metrics and explanations to facilitate cost comparison across different products: (1) Total Cost of Capital, (2) APR, (3) Average Monthly Payment, (4) Cents on the Dollar, and (5) Prepayment Options.

The ILPA is the leading voice in urging clear and sensible regulation of the online commercial lending industry. It welcomes engagement with legislators and regulators at both the federal and state levels and has participated in ongoing efforts to craft laws, rules, and guidelines that ensure responsible, affordable, and fast access to credit for small businesses.

The ILPA and its members have a keen interest in the interpretations of long-standing legal principles affecting the online lending industry and its customers. This case involves two issues in particular that directly impact the ILPA's membership and the online lending industry more broadly: (a) the concept of identifying a "true lender" different from the lender specified in a loan agreement; and (b) the enforceability of contractual choice-of-law provisions. This Court's treatment and discussion of both could have far-reaching, unintended consequences beyond the particular facts of this case for the online lending industry and, more importantly, for the consumers and small businesses it serves, who could be harmed by an overbroad ruling that reduces the availability of capital. The ILPA respectfully submits this brief to offer industry perspective on these principles.

STATEMENT OF COMPLIANCE WITH RULE 29

Pursuant to Federal Rule of Appellate Procedure 29(a)(4)(E), counsel for amicus curiae states that no counsel for the parties named in this case has authored the brief in whole or in part; no party or counsel for the parties named in this case has contributed money that was intended to fund preparing or submitting the brief; and no person—other than the amicus curiae, its members, and its counsel—contributed money that was intended to fund preparing or submitting the brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

It used to be that to get a commercial loan, one had to go to a brick-and-mortar bank. The application process was frequently cumbersome and time-consuming, and approval by the bank was far from certain; after going through the arduous application process, it would all too often turn out that the dream of expanding a small business or renovating a home was out of reach. In certain "unbanked" or "underbanked" communities, moreover, small businesses and individuals simply had no access to credit at all.

But in recent years, for millions of small businesses and consumers, things have changed. As modern technology has dramatically altered the way financial services are delivered, online lending platforms have revolutionized the lending experience and the financial products offered. A prospective small business borrower needs only to go online to compare financing options, apply, and get approved—sometimes within minutes. Online lending platforms also use advanced underwriting algorithms, machine learning and artificial intelligence ("AI"), and data analytics to better assess creditworthiness. Often, these efficiencies allow online lending platforms to offer a greater range of financing products when compared with traditional banks—for example, loans with shorter terms or smaller dollar amounts. For the dry cleaner eyeing a second storefront, or the e-commerce site adding holiday inventory, online lending platforms have dramatically expanded access to capital.

While they provide innovative financing products and services, online lending platforms typically operate under long-established legal frameworks and traditional regulatory oversight. As described in greater detail below, most platforms operate using one of two models. The first is the "bank partnership" model, under which a federally regulated bank makes the loans; the online lending platform markets and services the loans, within the bank's credit policy, as a third-party vendor to the bank; and—in some partnerships—the platform purchases some or all of the interest in the loans. The other is the "direct lender" model, under which the platform markets, makes, and services the loans, operating under applicable state law. Neither of these models is at issue in this case, because Appellee-Cross-Appellant CashCall has not partnered with a bank, sought state licenses, or relied on choice-of-law provisions that validly select the law of its home state. Indeed, the district court's factual findings here suggest the view that unlike these legitimate and well-established models, CashCall's partnership with the Cheyenne River Sioux Tribe was an artifice. *Infra* § I.

Nevertheless, the district court's broad reasoning in this case—if adopted by this Court in full—could needlessly implicate the models described above. The ILPA respectfully urges the Court to approach the following two issues cautiously to avoid that result.

First, the district court adopted an expansive version of so-called "true lender" principles. A handful of courts, now joined by the district court here, have resorted to true lender principles to find that the subsequent *purchaser* of a loan should be treated as the *lender*, and therefore should be subject to state usury and consumer protection laws as if it made the loan itself. Here, the district court found that a loan purchaser could be recharacterized as a lender if it had the "predominant economic interest" in the loan.

The district court cited no pertinent source of authority for these true lender principles—that is, it cited no binding federal statute or regulation, and no state statute, regulation, or common law from any jurisdiction relevant here. Similarly unfounded is the nebulous "predominant economic interest" standard the district court adopted. The court never explained what counts as an economic interest, when or why one party's interests predominate over another's, or why this inquiry would justify disregarding the status of the documented lender. Because there is no legal support for nor a practicable or methodical way to apply the district court's standard, this Court should reject it.

Second, the district court disregarded the choice-of-law provision concerning the loans at issue here, in part on the ground that enforcing it would conflict with the "fundamental public policy" of each of the states at issue. It reasoned that each state law contains its own interest rate cap and invalidates loans above its respective cap. The district court failed to explain, however, why the mere adoption of a particular cap (and the articulation of an accompanying remedy) rises to the level of a "fundamental" policy, and such a broad holding would generate state-by-state conflicts of law all across the country. Read broadly, the district court's position could even implicate direct lender models that rely on choice-of-law provisions. Fortunately, this Court need not reach this issue, because it can affirm on the fully independent choice-of-law rationale that the Cheyenne River Sioux Tribe lacks a sufficient relationship to the transaction at issue here. *Infra* § II.

Resolving the issues in this case narrowly will help to preserve the considerable benefits of online lending platforms. A recent ILPAcommissioned study of small business financing showed that from 2015 to 2017, the $10 billion in credit attributable to just five online lending platforms created over $23 billion in sales for borrowers.[2] Many of these borrowers hail from underserved communities and are much less likely to get credit from traditional banks. If, however, an overly broad reading of true-lender or choice-of-law principles creates uncertainty in the legal underpinnings of established models employed by online lending platforms, those platforms may be forced to curtail or cease offering loans in certain markets. *Infra* § III.

To be clear, the ILPA takes no position on the ultimate merits of this case. The overbroad and erroneous rulings adopted by the district court, however, if not rejected or significantly limited in scope, could threaten the enhanced access to credit with transparent and competitive pricing enjoyed by consumers and small businesses thanks to online lending platforms. The ILPA respectfully urges the Court to

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[2] *See* Nam D. Pham et al., *The Economic Benefits of Online Lending to Small Businesses and the U.S. Economy* 9, NDP Analytics (May 2018) ("NDP Report"), http://tinyurl.com/NDPReport; *see also* Oxford Economics, *The Economic Impact of Lending Through Funding Circle* 38 (June 2018), http://www.fundingcircle.com/US/impact (attributing 14,800 jobs and $13 billion in contributions to GDP to loans made by one platform, Funding Circle, in 2017).

reject expansive standards that risk implicating legitimate activity, and to decide this case narrowly on the basis of the facts and circumstances presented.

ARGUMENT

I. Online Lending Platforms Operate Based On Well-Established Legal Principles And Under Extensive Regulatory Oversight.

There are different types of online lending platforms. Some focus on consumer lending, while others provide credit for small businesses. Their underwriting models, use of technology, and financing products vary as well. But as a general matter, dominant models have emerged, and two of the most dominant models for online lending platforms rest on sound and long-established legal principles and are subject to extensive federal regulatory oversight. U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* 87 (July 2018) ("Treasury Fintech Report"), http://tinyurl.com/ustreasuryreport. We briefly discuss these two dominant models.

Bank Partnership Model. Under the "bank partnership model," an online lending platform will enter into a contractual relationship with a federally regulated bank.[3] The bank, in this model, originates the loan, while the online lending platform markets and services the loan. Treasury Fintech Report, *supra*, at 87. This model allows the two partners each to do what they do best. The bank will set underwriting standards concerning creditworthiness and risk tolerance, which are then incorporated into the technology-driven underwriting and servicing capabilities of the online lending platform. The platform then uses its technology to interface with prospective borrowers, describing and marketing available financial products and managing the application process. Where an applicant satisfies the bank's credit standards, the bank will originate and fund the loan. The online lending platform will then service the loan, collect payments, and, in many cases, offer customer service.

What becomes of the loans after the bank has originated and funded them will differ depending on the partnership. The bank may

[3] As explained in greater detail below (at 13-14), the bank partnership model rests on federal law applicable to federally-insured depository institutions, including not just national banks, but also state-chartered FDIC-insured banks, or other entities like credit unions that have obtained federal deposit insurance. We use the term "bank" or "federally regulated bank" for ease of reference.

sell some or all of the interest in the loans to the online lending platform, which in turn may securitize them and market them to investors. Alternatively, the bank may hold the loans or sell them to other third parties.

From a legal perspective, though, the most important thing about the bank partnership model is that the federally regulated bank, as the lender, is subject to the full spectrum of federal or state banking laws, rules, and regulations. This is significant for two reasons.

First, it means that every loan made by the bank under a bank partnership model is subject to stringent regulatory oversight. The federally regulated partner banks are subject to "general safety and soundness authority" under federal law. Treasury Fintech Report, *supra*, at 73-74. The banks, moreover, are subject to periodic evaluations, 12 U.S.C. § 1820(b), (d), which test "compliance with laws and regulations," FDIC Risk Management Manual § 1.1. Federal and state examiners regularly examine the banks' lending practices to ensure the safety and soundness of each bank and the compliance of its operations, including with respect to loans sold to third parties. The Bank Secrecy Act, Equal Credit Opportunity Act, Fair Credit Reporting

Act, and rules governing federal and state unfair and deceptive practices, among others, are within the scope of such examinations. Banks are thus subject to "a multitude of statutory provisions implemented by an army of regulators issuing myriad rules and regulations." Melanie L. Fein, *Banking and Financial Services: Banking, Securities, and Insurance Regulatory Guide*, Vol. I. § 3.01, at 3-5 (2006).

In the context of bank partnerships, online lending platforms are third-party service providers that are similarly subject to rigorous oversight. Indeed, the Bank Service Company Act "grants federal banking regulators authority to examine and regulate the provision of certain services that a third-party service provider … performs for regulated institutions." *Id.*; *see* 12 U.S.C. § 1867(c).

The banks' regulators hold the banks responsible for the products, services, and actions of their third-party service providers. Banks are therefore required to maintain ongoing risk management, monitoring, training, and compliance programs to manage the activities of their service providers. In fact, federal regulators have explicitly stated that they will evaluate lending activities conducted through third-party relationships as if the activity were handled within the institution. *See* Office of the Comptroller of the Currency, OCC Bulletin 2013-29, *Third Party Relationships: Risk Management Guidance* (Oct. 30, 2013). Thus, the use of the bank partnership model puts the onus on the partner bank to ensure activities conducted by its third-party service providers—in this case, the online lending platforms—"are conducted in a safe and sound manner and in compliance with applicable laws and regulations, just as if the institution were to perform the activities in house." Treasury Fintech Report, *supra*, at 74.

The second important upshot of a partnership with a federally regulated bank is that such bank has the right to issue loans at interest rates allowed under federal law—the power of "federal interest rate preemption." Under the National Bank Act, any bank that has obtained a national bank charter "may take, receive, reserve, and charge on any loan … interest at the rate allowed by the laws of the State … where the bank is located." 12 U.S.C. § 85. The Supreme Court has long held that contrary state law is preempted by this statute. Thus, if a national bank located in one state lends to a borrower in another, the applicable interest rate cap is that of the bank's home state—even if that home state has no interest rate cap at all. *Farmers' & Mechs.' Nat'l Bank v. Dearing*, 91 U.S. 29 (1875); *Marquette Nat'l Bank of Minn. v. First of Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978). Any interest rate cap in the borrower's state's usury law is inapplicable. *Beneficial Nat'l Bank v. Anderson*, 539 U.S. 1, 11 (2003) ("[T]here is, in short, no such thing as a state-law claim of usury against a national bank.").

State-chartered banks that are insured by the Federal Deposit Insurance Corporation (FDIC) have this same power under federal law to "export" their home state's interest rate. 12 U.S.C. § 1831d. As the Third Circuit has explained, federal law "completely preempts any state law attempting to limit the amount of interest and fees a federally insured-state chartered bank can charge." *In re Cmty. Bank of N. Va.*, 418 F.3d 277, 295 (3d Cir. 2005); *see* Federal Deposit Insurance Corporation, Interpretive Letter 93-27, *12 U.S.C. § 1831d Preempts Contrary State Common Law Restrictions on Credit Card Loans*, 1993 WL 853492, at *1 (July 12, 1993) (§ 1831d "preempts the laws of an out-of-state borrower's home state, to the extent that such laws purport to restrict the interest … that an FDIC-insured state bank is authorized to assess by its chartering state").

Through federal interest rate preemption, the online lending platform and the federally regulated bank provide access to credit within the interest rate cap set by the bank's home state. This allows the partnership to offer products subject to uniform regulation. And importantly, federal interest rate preemption has long been understood to adhere to a loan even after a bank assigns or sells the loan to a non-bank third party. This is because of the "cardinal rule" that "a contract, which, in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction." *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833). As the Fifth Circuit has put it, "[t]he non-usurious character of a note should not change when the note changes hands." *FDIC v. Lattimore Land Corp.*, 656 F.2d 139, 148-49 (5th Cir. Unit B 1981).

Direct Lending Model. The other dominant model employed by online lending platforms is the direct lending model. Under this model, an online lending platform operating as a direct lender will typically originate, fund, service, and market the loans itself. Under the direct lending model, the online lending platform may hold the loans on its balance sheet, sell some portion of the loans to third parties, or securitize the loans and market them to investors.

To lend in a particular state, the online lending platform must adhere to that state's law—for instance, by obtaining state lending licenses where necessary. "Under the direct lending model, [online lending platforms] must have licenses in most states where they do business and are subject to oversight in those states." Treasury Fintech Report, *supra*, at 90. Direct lenders are also subject to applicable provisions of the Equal Credit Opportunity Act, Fair Credit Reporting Act, and unfair and deceptive practices acts.

If permitted by state law, a direct lender may rely on contractual choice-of-law provisions in a loan agreement with a borrower. These provisions may, similar to the effect of federal preemption, impose the applicable interest rate cap of the online lending platform's home state, rather than the borrower's state. Such provisions are enforceable unless "the chosen state has no substantial relationship to the parties or the transaction" or "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state." Restatement (Second) of Conflict of Laws § 187; *cf.* ER 213:9.

* * *

This case does not directly involve either of the models discussed above. According to the district court, CashCall's model was based on a supposed partnership with Western Sky Financial, a limited liability company organized under the law of the Cheyenne River Sioux Tribe (CRST). ER 213:2. Under this arrangement, according to the district court, CashCall would provide funds to Western Sky to allow Western Sky to fund consumer loans; the loan agreements with borrowers specified that CRST law applied. ER 213:3. Three days later, California-based CashCall would automatically buy the loans at a premium. ER 213:3. Many of these consumer loans were for small amounts at extremely high interest rates. ER 213:3.

CashCall's operation is clearly different from the bank partnership model discussed above (at 10-15). Under that model, the platform partners with a *federally regulated bank*, which funds the loans subject to federal or state law. Western Sky, however is not a federally regulated bank.

Nor could CashCall rely, as under the direct lending model discussed above (at 15-17), on state licenses or an enforceable choice-of-law provision selecting the home state law of the lender. CashCall "opted not to obtain licenses." ER 213:2. As for choice of law, the loan agreements selected not the law of CashCall's home state of California, but CRST law—a body of law that, the district court found, had no connection to the parties or the loan transactions. ER 213:4. By contrast, a direct lender whose loan agreements select the lender's home state law necessarily has a connection to and interest in the transaction.

That CashCall is such an outlier is reason enough to approach this case with caution. The two primary models employed by online lending platforms rest on well-established legal principles and are subject to extensive regulation to ensure borrower safety. CashCall's model is far different. The district court's decision in this case should reflect CashCall's unique facts, which are easily distinguishable from the two primary models employed by online lending platforms. Further, the decision should not inadvertently and adversely impact online lending platforms and their customers.

II. This Court Should Reject, Or, At A Minimum, Limit The District Court's Broad Reasoning On True Lender And Choice-Of-Law Issues.

The district court's reasoning was unnecessarily broad. In rejecting CashCall's model, it relied on expansive interpretations of two legal concepts—"true lender" and choice-of-law principles—which risk an indirect effect on the many small businesses and individuals that benefit from online lending platforms.

The district court's analysis of CashCall's arrangement proceeded in two steps. First, the court sought to "determine the identity of the parties to the loan agreements," applying the so-called "true lender" approach. ER 213:6. The court found that CashCall should be treated as the "true lender," even though Western Sky's name appeared on the loan documents. It reasoned that CashCall "assumed all economic risks and benefits of the loans," and "bore the risk of default as well as the regulatory risk." ER 213:8.

Step two of the court's analysis was to apply choice-of-law principles to the loan agreements' CRST choice-of-law clauses. It found the clauses unenforceable because—once California-based CashCall was substituted for Western Sky as "true lender"—CRST law "ha[d] no substantial relationship to the parties or the transactions and there is no other reasonable basis for the parties' choice of CRST law." ER 213:8 (citing and applying Restatement (Second) of Conflict of Laws § 187(2)(a)).

The court also independently found that "[a]pplication of CRST law would be contrary to a fundamental public policy" of each of the borrowers' home states. ER 213:9. The court reasoned that this was because each of the more than a dozen states "ha[s] expressed a fundamental public policy in protecting its citizens from usurious loans and unlicensed lenders." ER 213:9. The court then applied each borrower's state law to its loan agreement.

The ILPA takes no position on the ultimate correctness of the district court's decision to apply the borrowers' state law to the loans at issue and to hold CashCall liable on that basis. As discussed below, however, the district court's applications of both the "true lender" and choice-of-law principles are dubious in important respects. The ILPA respectfully urges the Court to clarify the relevant legal principles to provide certainty and avoid unintended consequences.

A. The district court's broad conception of "true lender" principles is unsupported, impracticable, and unnecessary.

The district court adopted "true lender" principles that disregarded the lender identified in the loan agreements and substituted CashCall as the lender. It suggested that the standard for determining the "true lender" turns on which party has the "predominant economic interest." ER 213:6-7. This concept is flawed.

To begin with, this Court should reject the very notion of a generally applicable, free-floating "true lender" theory. The district court identified no binding statute, regulation, or common law source as grounding for such a conclusion. And there is very little basis indeed.

The type of "true lender" inquiry applied by the district court is of relatively recent vintage. As far as case law, the principle seems to be derived from a 2007 decision of a New York State intermediate appellate court, *People ex rel. Spitzer v. Cty. Bank of Rehoboth Beach*, 846 N.Y.S.2d 436 (3d Dep't 2007), a case involving an arrangement between a payday lender and a bank that the FDIC shut down in light of "unsafe and unsound banking practices," *id.* at 438. The court there acknowledged that, under "federal regulatory guidelines," the lender is the party that was responsible for "the decision to extend credit, the extension of such credit, and the disbursal of the proceeds of the loan." *Id.* To "determine who is the 'true lender,'" the court thought "the key factor [was] 'who had the predominant economic interest' in the transactions." *Id.* at 439. *Rehoboth* cited no legal authority for the terms "true lender" or "predominant economic interest."

These concepts have surfaced sporadically elsewhere. Georgia, for instance, codified in its payday lender law a test that brands a party a "de facto lender" when "the entire circumstances … show [that it] … maintains a predominant economic interest." Ga. Code Ann. § 16-17-2(b)(4). A few scattered state courts or federal district courts have also applied this inquiry without identifying any foundational source of authority.[4] The concept, however, has not been broadly adopted, widely

[4] *E.g.*, *CashCall, Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300, at *1 (W. Va. May 30, 2014); *Pennsylvania v. Think Finance, Inc.*, No. 14-cv-7139, 2016 WL 183289, at *11, *13 (E.D. Pa. Jan. 14, 2016); *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, 1195, 1203 (N.D. Cal. 2012).

applied, or securely grounded in legal authority. In fact, other courts have rejected the concept altogether.[5]

Of course, rules should flow from some source of authority. Before adopting and applying a broadly applicable "true lender" inquiry, the district court needed to identify federal or state law supporting it. Its failure to do so renders its reasoning suspect.

The dangers of adopting a scantily supported true lender approach are palpable. Indeed, it would be especially troubling to not only the online lending industry, but also to the soundness of the banking system as a whole, if true lender principles permitted courts to disregard the status of a federally regulated bank as a lender. Federal law confers upon a federally regulated bank the ability both to issue loans at contracted rates and to sell those loans with their full terms

[5] *E.g.*, *Beechum v. Navient Sols., Inc.*, No. EDCV 15-8239-JGB-KKx, 2016 WL 5340454, at *6 (C.D. Cal. Sept. 20, 2016) (declining to consider allegations that "substance" of transaction justify disregarding lender status); *Sawyer v. Bill Me Later, Inc.*, 23 F. Supp. 3d 1359, 1367 (D. Utah 2014) (rejecting argument that "true lender" principles could overcome preemption of state law); *see Hudson v. Ace Cash Express, Inc.*, No. IP 01-1336-CH/S, 2002 WL 1205060, at *6 (S.D. Ind. May 30, 2002) (declining to scrutinize "precise extent of financial risk accepted by the national bank" for purposes of determining "boundaries between federal and state bank regulation").

intact. *See* 12 U.S.C. § 85 (power to issue loans); 12 C.F.R. § 7.4008 (power to sell loans); *Planters' Bank of Miss. v. Sharp*, 47 U.S. (6 How.) 301, 322 (1848) (recognizing that power to sell loans is a "necessarily implied" corollary to the power to issue loans). These powers are critical because they permit banks to move loans off their balance sheets (providing increased liquidity to enable more lending), manage exposure to market fluctuations, and comply with capital requirements—all of which, in turn, lowers costs for borrowers and expands access to capital.

The district court's expansive "true lender" inquiry, if applied to federally regulated banks, would interfere with these long-established federal banking principles. There is no basis for a concept of such uncertain foundation to invade the province of federal banking regulators. If this Court does recognize a true lender concept in this case, it should make clear that it applies narrowly only to the facts of this case and does not apply in the context of partnerships with federally regulated banks.

This Court, moreover, should reject the district court's formulation of the true lender inquiry. The district court's "predominant economic interest" test is vague, confusing, and not necessary to reach the result. Although other courts have used this language, no court has explained what it could mean. What counts as an "economic interest"? Ownership of the note? Right to a share of interest and repaid principal? How are the various interests tallied up and quantified? And just how much of its "economic interest" may or must an originating lender share with another party in order for the law to disregard the fact that the lender originated the loan? Neither the district court nor the cases it cited answer these questions.

There is thus no basis in the case law or common sense to adopt a vague, incomplete "predominant economic interest" standard. If they apply at all, true lender principles should operate only where the lender on the face of the loan is not a federally regulated bank, and where facts and circumstances establish that such nominal lender exercises no authority, discretion, or control with respect to the relevant terms, conditions, and credit decisions.

In any event, it is not necessary to settle upon a true lender standard in this case. The district court's findings of fact suggest that it would have found CashCall to be the "true lender" even under a standard that requires a nominal lender to have no substantive involvement in terms, conditions, or credit decisions. Or, alternatively, the district court could have simply considered Western Sky's diminished interest in the transactions at issue within the choice-of-law analysis, which already evaluates the parties' relationship to the transaction and hence interest in the law that applies to it. *Cf.* ER 213:8-9. That would have obviated any need for the court to engage in a separate true lender analysis.

B. The district court's "fundamental public policy" rationale for declining to enforce the choice-of-law clause is dubious and unnecessary to resolution of the case.

The district court's choice-of-law analysis is also questionable in at least one other important respect. After finding the CRST choice-of-law clause unenforceable because CRST law lacked any relationship to the parties or the transaction, *supra* 20, the court could have ended its analysis. Instead, it also ruled the clause unenforceable on the independent ground that it was contrary to the "fundamental public policy" of each of the states at issue. ER 213:9. The district court appeared to reason that because each state has its own usury law, interest rate caps, and licensing requirements, such laws are automatically expressions of fundamental policy.

The mere existence of state law on a topic does not make the content of that law a "fundamental public policy." Rather, it is well-settled that a choice-of-law clause will not be disregarded "merely because [applying the chosen state's law] would lead to a different result than would be obtained under the local law of the state of the otherwise applicable law." Restatement (Second) of Conflict of Laws § 187 cmt. g. Moreover, the court did not articulate how the mere selection of different interest rate caps from one state to another, or the existence of remedies for exceeding those caps, automatically raises the law to the level of "fundamental public policy." At the very least, because choice-of-law clauses are presumptively valid, a court must articulate why a state's interest rate cap is so significant that state law prohibits its citizens from opting into the law of an out-of-state lender operating legitimately pursuant to its home state law. The court did not make this rationale clear for any of the states at issue, let alone all of them.

Again, this Court need not reach this issue. Instead, it can rule solely on the fully independent ground that the parties to the loans lack any connection to CRST law.

III. An Overly Broad Ruling On True Lender And Choice-Of-Law Issues Could Threaten Access To Credit For Small Businesses.

A narrow ruling will also avoid threatening the expanded access to credit online lending platforms have afforded to consumers and small businesses. As described below, those benefits are very real. But so too are the risks of overbroad case law.

As the Treasury Department recently acknowledged, online lending platforms have expanded access to credit for consumers and small business alike. Treasury Fintech Report, *supra*, at 11. The success of online lending for small businesses in particular was recently documented in a report published by NDP Analytics. NDP Report, *supra*. The Report analyzed available data on small businesses' contributions to the U.S. economy; their ability to meaningfully obtain credit; the role of online lending platforms in serving these businesses; and the economic impact from online loans on borrowers and their communities. The results fully support the significant value that online lenders provide to small business and the communities they serve.

There are nearly 30 million small businesses in the United States. U.S. Small Business Administration, *United States Small Business Profile 2017* 1 (Jan. 18, 2017), http://tinyurl.com/SBAProfile2017. They employ almost 60 million people, accounting for nearly half of the private sector workers in the U.S. *Id.* They are job *creators*, too—since 1995, two out of every three new jobs were created by small businesses. NDP Report, *supra*, at 2.

Almost three-fourths of all small businesses will at some point "seek small loans to start, operate, or expand their businesses." *Id.* The local flower shop owner dreams of expanding to wholesale, the dry cleaner needs to hire an employee, the neighborhood restaurant is ready for a second location, and so on. But the credit is often not there or too difficult to obtain in a timely fashion. Indeed, "[t]he credit gap is one of the top challenges for small businesses, especially those with less than $1 million in annual revenue." *Id.* at 3. According to the Federal Reserve, in 2017, 54% of all small businesses were unable to get the amount of financing they sought, and 23% were denied credit altogether. U.S. Federal Reserve System, *2017 Small Business Credit Survey: Report on Employer Firms* (May 2018), http://tinyurl.com/Fed2017Report.

One significant factor underlying these persistent credit shortfalls is the reluctance of traditional banks to lend to small businesses. NDP Report, *supra*, at 3-4. Small business lending is simply not a key component of a traditional bank's business model. Such backs often lack the expertise or systems to understand a small business's cash flow, assets, historical growth, business model, or creditworthiness. They also often lack the ability or appetite to service thousands of small-dollar loans when large-scale corporate and industrial lending is considerably more profitable.

In recent years, however, hundreds of thousands of small businesses have been able to obtain credit through online lending platforms. The 2017 Federal Reserve Small Business Credit Survey showed that online lending platforms are more likely than traditional banks to approve loans for borrowers of all categories of credit risk. 2017 Small Business Credit Survey, *supra*, at 13. For medium or high credit risk applicants—for whom the credit gap is most daunting—the differential is staggering: Online lending platforms approve financing for 71% of such applicants, while small banks approve financing for only 47%, and large banks approve only 35%. *Id.*

Online lending platforms have thus been a boon to Main Street. About a quarter of the loans made with the assistance of online lending platforms are extended to the smallest businesses, those with less than $100,000 in annual revenue. NDP Report, *supra*, at 6. And nearly one third of those loans went to businesses located in lower-income communities. *Id.* at 8. NDP determined that "for every one dollar in lending to small businesses between 2015 and 2017, sales … increased between $1.05 and $2.84." *Id.* at 10. On a macro level, the $10 billion in small business lending attributable to the five online lending platforms included in the study created over $23 billion in sales for their borrowers' businesses. *Id.* at 9. A similar study examining the economic impact of one online lender, Funding Circle, revealed similar results; it found that Funding Circle loans fueled 14,800 jobs and $13 billion in contributions to GDP in 2017. Funding Circle Impact, *supra*, at 38.

To continue to deliver these substantial benefits to small businesses and the broader public, the online lending industry depends on clarity and certainty in the law. For example, an online lending platform operating under a bank partnership model must be able to rely on the federally regulated bank's established right to issue loans consistent with federal law and the right under federal law to sell and securitize those loans. *Supra* 13-15. If an unprincipled extension of true lender principles were to cast doubt on federal statutory preemption—potentially subjecting online lending platforms and their bank partners to a patchwork of 50 inconsistent sets of state law—many online lending platforms could be forced to curtail (or cease) lending. Millions of consumers and small businesses would lose a vital source of credit.

This is no idle concern. The Second Circuit's 2015 decision in *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), is an object lesson in the unintended consequences of overbroad reasoning. In *Madden*, the Second Circuit held that a third-party debt collector could not rely on federal interest rate preemption to collect a loan that was validly issued by a bank at a particular interest rate. *Id.* at 249-51.

Even in the context in which it was decided—a debt collector's ownership of defaulted debt—the *Madden* decision was heavily criticized, including by an amicus brief filed by the Solicitor General and Comptroller of the Currency before the Supreme Court. Br. for the United States, *Midland Funding, LLC v. Madden*, No. 15-610, 2016 WL 2997343 (U.S. May 24, 2016).

The concerned observation of one commentator that *Madden* threatened "far-reaching—and likely unintended—implications for national banks and their assignees" by "upend[ing] a fundamental and longstanding premise of lending law" proved to be true. Nathan Bull et al., *Second Circuit Holds Application of State Usury Laws to Third-Party Debt Purchasers Not Preempted By National Bank Act*, JD Supra Business Advisor (June 9, 2015), http://tinyurl.com/JDSupArticle. Though the case had nothing to do with online lending platforms or their dominant models, the upshot was swift and unmistakable: Online lending platforms increasingly shied away from states within the Second Circuit, and, as documented by a 2017 study, access to credit diminished—especially for higher-risk borrowers traditionally left out of the banking system. Colleen Honigsberg, Robert J. Jackson, Jr., Richard Squire, *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & Econ. 673 (2017). Meanwhile, lenders across the country, not just online lending platforms, have been forced to spend considerable resources advocating for legislation limiting or undoing the *Madden* decision. *See* Treasury Fintech Report, *supra*, at 92-93 (recommending such legislation).

This Court should accordingly exercise caution to ensure that businesses and consumers are not needlessly cut off from credit.

CONCLUSION

For the reasons stated, the ILPA respectfully requests that the Court decide this case narrowly to avoid indirect and unintended effects on legitimate online lending platforms.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the length limits permitted by Ninth Circuit Rule 32-1 and Fed. R. App. P. 29(a)(5). The brief is 6472 words, excluding the portions exempted by Fed. R. App. P. 32(f).

This brief's type size and type face comply with Fed. R. App. P. 32(a)(5) and (6), because the brief has been prepared in a proportionally spaced typeface using Microsoft Word 2013 in Century Schoolbook 14-point font.

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on October 26, 2018.

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