

CFPB v. CashCall Marks Victory for UDAAP Claims Based on State Law

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The recent decision of a California federal court in *Consumer Financial Protection Bureau v. CashCall, Inc.*¹ represents a significant victory for the Consumer Financial Protection Bureau's (CFPB) efforts to use state usury and other consumer protection laws to pursue claims of unfair, deceptive, or abusive acts and practices (UDAAP) against lenders and debt collectors. All institutions that conduct lending and debt collection activities—especially marketplace lenders and other entities that partner with depository institutions to rely on federal preemption—should take careful note of the decision.

CashCall is in the business of unsecured consumer and small business lending. It operates under a distinctive legal arrangement: the loans are issued over the internet by a separate tribal entity, known as Western Sky Financial, located in the Cheyenne River Sioux Tribe reservation in South Dakota. Loans are funded from capital provided to Western Sky by CashCall, which in turn agrees to purchase the loans from Western Sky within several days of issuance. The loan contracts specify the laws of the Cheyenne River Sioux Tribe as the governing law.

In 2013, the CFPB sued CashCall, along with its owner, a subsidiary and an affiliate, alleging that the defendants engaged in unfair, deceptive, and abusive practices in collecting on void or uncollectible debts. The Bureau claimed that the debts were void because they were in excess of state usury caps or issued without proper state licensing. The crux of the dispute concerned whether the usury laws of borrowers' home states applied to CashCall's loans, as the CFPB claimed, or instead tribal law applied. The Bureau contended that the contractual choice of tribal law should be disregarded, arguing that CashCall was the "true lender," not Western Sky, and that choice-of-law principles dictated application of state usury and licensing laws. CashCall argued that tribal law should apply, and that in any event, it was not unfair, deceptive, or abusive to rely on tribal law in collecting on the loans. The district court considered these arguments on cross-motions for summary judgment, and ruled for the Bureau.

"True Lender" Analysis

The decision's analysis is important in several respects. First, the court placed significant weight on its determination that CashCall, rather than Western Sky, should be deemed the “true lender” of the loans at issue—that is, the court disregarded the fact that Western Sky formally originated the loans and looked instead to the “substance” of the transaction. The court concluded that CashCall's involvement in the loan program rendered it “the ‘true lender’ and real party in interest.”² According to the court, “*CashCall* bore the risk of default as well as the regulatory risk” for the loans. Among the facts cited for this conclusion were CashCall's advancing of funds to Western Sky to fund two days' worth of loan originations, its purchase of all the loans before any payments were made by borrowers, and its agreement to indemnify Western Sky for civil, criminal, and administrative liability.

The “true lender” analysis applied by the court is not well developed, but has previously surfaced in cases in a variety of contexts. Notably, plaintiffs have argued that courts should look beyond the legal formality of the loan origination, to the “true lender,” in determining whether to apply federal preemption.³ The theory thus has obvious significance for banks and entities that partner with banks and rely on the preemptive effect of federal law. Thus far, “true lender” arguments have had only limited success, but the CashCall decision could give those arguments new life. As if to highlight this risk, the CFPB relied in its briefing on the Second Circuit decision in *Madden v. Midland Funding, LLC*⁴ to argue that, like CashCall, assignees of loans issued by national banks cannot rely on federal preemption to avoid state usury laws. (This argument was especially remarkable because the US Solicitor General had advised the Supreme Court, less than two months earlier, that the United States views *Madden* as wrongly decided on precisely this point.)⁵

Despite the court's reliance on the “true lender” theory, it remains a bit of a puzzle what the theory is supposed to do. Preemption analysis does not appear to need it: a court could very well decide whether applying state law would “prevent or significantly interfere with the national bank's exercise of its powers” without engaging in a “true lender” analysis.⁶ For example, if the application of state usury laws would interfere with a bank's powers to establish interest rates on loans and to sell those loans, then those laws should be preempted regardless of any “true lender” analysis. In *CashCall*, the court's “true lender” theory did not concern federal preemption, but rather was apparently used to support the choice-of-law analysis. Choice-of-law principles did not require the court to determine the “true lender,” but the court's determination served to minimize the extent and nature of the Cheyenne River Sioux Tribe's connection to the transaction. Treating CashCall as the “true lender,” and not Western Sky, thus paved the way for the court to sidestep legal authority that accords almost dispositive weight to a contractual provision selecting the law of a contracting party's domicile.⁷ The risk—and it is a serious one—is that other courts relying on *CashCall* could undertake a “true lender” analysis as a threshold matter in cases involving choice-of-law or preemption issues.

UDAAP Enforcement of State Law

The *CashCall* decision is important for a second reason: it marks a significant victory for the CFPB in its effort to premise federal UDAAP claims on violations of state law. According to the Bureau's theory, state usury and licensing laws rendered the *CashCall* loans void or uncollectible, and it was thus unfair, deceptive, and abusive for CashCall to collect on them. Limiting its analysis to the

deception claim, the court concluded that CashCall engaged in a deceptive practice by “creat[ing] the ‘net impression’ that the loans were enforceable and that borrowers were obligated to repay the loans” under tribal law.⁸ Further, the court dismissed as “irrelevant” CashCall’s argument that it was merely enforcing the terms of the loan contracts.⁹ It also rejected CashCall’s argument that the Bureau’s UDAAP claim was precluded by CashCall’s reasonable belief that the contracts’ choice of tribal law would be given effect. The court characterized this as a straightforward mistake of law defense, and rejected it on the ground that ignorance of the law is no excuse.

The court’s questionable analysis of this issue has significant implications for the Bureau’s UDAAP authority. In treating CashCall’s argument as a mistake-of-law defense, the court suggested that virtually any violation of state law that renders a loan void or uncollectible could give rise to automatic enforcement liability for deceptive practices. Under the court’s analysis, for example, an entity collecting loans in excess of state usury caps in reliance on federal preemption could be subject to automatic UDAAP enforcement liability if a court were to find preemption inapplicable. This reasoning would, in effect, federalize all state law violations that arguably render a debt void or uncollectible. Yet the court’s opinion gave little consideration to these implications. Instead, it accused CashCall, remarkably, of seeking to “re-write the CFPB to include a general mistake-of-law defense.”¹⁰ Despite these gaps in the court’s reasoning, we expect that the CFPB will look for new opportunities to pursue UDAAP enforcement cases premised on state law.

Individual Liability

Finally, the decision is also significant for its analysis of the individual liability of CashCall’s owner, J. Paul Reddam. In finding the company liable, the court could, in some sense, rely on the notion that the CFPB need not prove intent to sustain a deception claim.¹¹ But the standard for *individual* liability is different. The court purported to require proof that Reddam “had knowledge of the misrepresentations, was recklessly indifferent to the truth or falsity of the misrepresentation, or was aware of a high probability of fraud along with an intentional avoidance of the truth.”¹² Reddam accordingly argued that he had a reasonable belief, informed by counsel, that tribal law applied and therefore he did not know that the contractual choice of tribal law would not be given effect by a court. In other words, Reddam relied on his understanding of the law to show that he lacked the requisite knowledge of any misrepresentation regarding the loans’ validity. Yet the court again rejected the argument as merely a mistake of law defense. In this respect, the court’s reasoning bodes poorly for individual employees of lenders and debt collectors who may wish to argue that they lacked the necessary intent to collect on void or uncollectible debts.

¹ Dkt. No. 15-7522 (C.D. Cal. Aug. 31, 2016).

² Op. at 8.

³ See, e.g., *Ubaldi v. SLM Corp.*, 852 F. Supp. 2d 1190, 1196 (N.D. Cal. 2012).

⁴ 786 F.3d 246 (2d Cir. 2015).

⁵ Brief of United States as Amicus Curiae, *Midland Funding, LLC v. Madden*, No. 15-610 (US filed May 24, 2016), at 6-13.

⁶ *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25, 33 (1996); see also *Marquette Nat’l Bank v. First of Omaha Svc. Corp.*, 439 U.S. 299, 313-19 (1978).

⁷ See Restatement (Second) of Conflict of Laws § 187(2) cmt. f.

⁸ Op. at 13.

⁹ *Id.* at 14.

¹⁰ *Id.* at 14.

¹¹ See CFPB Examination Manual, UDAAP, at 6 (v.2 October 2012) (“intent to deceive is not necessary for deception to exist”).

¹² Op. at 14 (quoting *CFPB v. Gordon*, 819 F.3d 1179, 1193 (9th Cir. 2016)).

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