

"True Lender" Litigation Heats Up: Small Business Sues Marketplace Lender And Partner Bank, Alleging Conspiracy To Evade Usury Laws

Article By:

David D. Christensen

Jennifer Janeira Nagle

Over the last several years, a number of U.S. state and federal government enforcement actions have challenged the viability of the bank partnership model that many marketplace lenders have used to fund consumer and small business loans. Specifically, regulators have argued that, in partnerships where the non-bank entity controls much of the funding process or the bank has little-to-no risk of loss, the non-bank entity is the “true lender.”

Under such circumstances, state regulators have sought and obtained steep penalties for violations of state lending laws, particularly usury limits. Similarly, the Consumer Financial Protection Bureau has convinced at least one court to hold that collecting on usurious loans originated under the bank partnership model is a violation of the federal Consumer Financial Protection Act (and recently tried the case seeking substantial penalties). (See *CFPB v. CashCall*, No. 15-cv-7522-JFW (C.D. Cal. Aug. 31, 2016))

Private litigants are now following suit. On October 12, 2017, a small business and its owner filed suit against Kabbage, Inc. and Celtic Bank in Massachusetts federal court (No. 17-cv-11976, D. Mass.), alleging that the defendants’ funding model was designed to evade Massachusetts’ usury law. Kabbage provides small business loans through its partnership with Celtic, an industrial bank chartered by the State of Utah. Plaintiffs obtained a number of loans and now allege that Celtic allowed Kabbage to “rent” its bank charter to originate usurious loans and that Kabbage is the “true lender” (in part because it allegedly bore the risk of loss). Plaintiffs assert claims under Massachusetts’ usury and consumer protection statutes, as well as under the federal RICO statute and the Lanham Act. Notably, plaintiffs seek to void the loan agreements, including the arbitration and choice-of-law provisions therein. Defendants have not yet had the opportunity to respond to the complaint.

The *Kabbage* case exemplifies the litigation risk inherent in using bank partnerships to originate high-interest loans, a practice that has become more common as fintech and traditional banking entities collaborate. We will continue to monitor developments in this case and other “true lender” litigation.

National Law Review, Volumess VII, Number 304

Source URL: <https://natlawreview.com/article/true-lender-litigation-heats-small-business-sues-marketplace-lender-and-partner-bank>