DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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WEST VIRGINIA SUPREME COURT UPHOLDS "TRUE LENDER" RULING

The West Virginia Supreme Court of Appeals upheld, without oral argument, several orders by a state trial court against CashCall, Inc., including the trial court's finding that CashCall is the "true lender" of a bank loan program. *CashCall, Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 30, 2014). The supreme court affirmed the trial court's order that CashCall pay $13.8 million in penalties and restitution and $446,180 in attorneys' fees and cost for (i) engaging in abusive debt collection practices, (ii) making and collecting interest on loans above West Virginia's 18% interest rate limitation and (iii) making loans without a license from the Department of Banking.

The trial court based its decision on the following findings of fact. First Bank and Trust of Millbank ("FBT") made small unsecured consumer loans with an annual percentage rate of between 59% and 96% to West Virginia residents. FBT is a federally insured South Dakota bank. CashCall entered into a marketing agreement with FBT to market and service these consumer loans. CashCall is a California-based consumer finance company. CashCall acted as an independent contractor and not as an agent of FBT. Within three days of each loan's origination, CashCall purchased the loan from FBT at a premium without recourse. FBT retained the origination fee and all interest that accrued prior to the purchase date. The marketing agreement obligated CashCall to purchase only loans that conformed to CashCall's underwriting guidelines. For financial reporting purposes, CashCall treated these loans as if CashCall funded them. The sole owner and stockholder of CashCall provided a personal guarantee to FBT for all of CashCall's monetary obligations and for the amount of all loans made and held by FBT prior to purchase by CashCall. CashCall also indemnified FBT against all losses arising out of the marketing agreement, including claims asserted by borrowers.

Initially, CashCall removed the case to federal court. CashCall argued that the state usury law claims are completely preempted by Section 27 of the Federal Deposit Insurance Act ("FDIA") because FBT is the "true lender" under the program. The federal district court dismissed and remanded the case to the West Virginia trial court because (i) the West Virginia Attorney General asserted state law claims against a nonbank entity, (ii) the claims did not implicate the FDIA, (iii) the FDIA does not completely preempt the state-law claims and (iv) there was no federal question on the face of the Attorney General's complaint. Based on a line of federal procedural rulings (all of which settled before being heard on the merits), the state trial court applied a "predominant economic interest" test to determine which entity is the "true lender" of the loans. The trial court held that CashCall is the "true lender" because CashCall bore the "entire monetary burden and risk of the loan program," and FBT faced no economic risk by originating loans.

The supreme court affirmed the trial court's findings of fact and reward of damages. The supreme court rejected CashCall's argument that the trial court should have applied a so-called "federal law" test instead of the "predominant economic interest" test. Citing *Discover Bank v. Vaden*, CashCall argued that FBT was the "true lender" of the loans under the "federal law" test because FBT (i) set the terms and conditions of the loans and (ii) actually extended credit to West Virginia residents. 489 F.3d 594, 601-03 (4th Cir. 2007). The supreme court criticized the "federal law" test because the test favors the form of a transaction over its substance and leads to the conclusion that a bank in a so-called a "rent-a-bank" scheme is always the "true lender." In analyzing usury claims, West Virginia precedent requires a court to look at the substance over the form of a transaction. The supreme court noted that the "predominant economic interest" test provides a means of examining the substance of CashCall's and FBT's marketing agreement. The court cited *Spitzer v. County Bank of Rehoboth Beach*, 846 N.Y.S.2d 436 (N.Y. App. Div. 2007), amount others, in a footnote to support the court's use of the "predominant economic interest" test. The *Spitzer* case involved a loan program where a payday lender (i) purchased 95% of each of the bank's loans, (ii) assumed all the risk of the loan and (iii) indemnified the bank against any loss arising from a loan transaction. The supreme court "easily" distinguished *Vaden* and *Krispen v. May Dep't Stores Co.* from *CashCall* because both cases involved a nonbank entity that was a corporate affiliate of the bank. *Krispin*, 218 F.3d 919 (8th Cir. 2000). The supreme court does not explain why this distinction makes a difference but it may relate to the court's view on agency.

The *CashCall* court arrived at a conclusion contrary to that of the Utah district court in *Sawyer v. Bill Me Later, Inc.*, a case decided on May 23, 2014. *See* our Alert on June 2, 2014. The *Sawyer* court held that the FDIA preempts the plaintiffs' state usury law claims

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regardless of whether the bank or the servicer is deemed the "true lender," deeming the policing of rent-a-charter arrangements to be better addressed by federal banking regulators or Congress. The *Sawyer* court further opined that the bank is the "true lender" of the credit program because the bank (i) was a party to the credit agreement under which the loans were made, (ii) funded the loan at issue and owned the credit accounts, (iii) held the loan for at least two days and (iv) continued to own the accounts and share in the financial upside of the program based on the amount of interest collected. In *Sawyer*, the nonbank entity was recognized as a service provider acting on behalf of the bank. Because of the timing of the *Sawyer* opinion, it is unlikely that the West Virginia Supreme Court of Appeals considered *Sawyer*. Regardless, the *Sawyer* decision may have had no impact on the West Virginia court because *CashCall*'s holding relies on West Virginia usury law recharacterization precedent and the lending programs at issue in *Sawyer* and *CashCall* have distinguishable characteristics.

In the wake of *CashCall* and *Sawyer*, case law continues to provide no clear standards as to adequate or sufficient structures or factors to assure that a court will respect the structure of a bank partnership loan program. We can advise you on program characteristics that we believe strengthen or weaken the argument that a bank is the "true lender" of a loan program. ❑

✧ *Mike Tomkies and Susan M. Manship*