DREHER TOMKIES LLP ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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CALIFORNIA DISTRICT COURT DISMISSES "TRUE CREDITOR" CASE

A California district court has dismissed a class action filed against a private student loan servicer alleging that the servicer was the "true creditor" and violated California's usury statute. *Beechum v. Navient Solutions, Inc.*, No. 15-8239, 2016 WL 5329553 (C.D. Cal. Sept. 21, 2016). The court rejected the plaintiffs' "substance over form" argument holding that the private student loans in question were issued by a national bank and qualified for California's statutory usury exemption for bank loans. The national bank was not a named party in the action. The facts in this case mirror the facts in *Ubaldi v. SLM Corp*, another "true creditor" case from a California district court. 852 F.Supp. 2d 1190 (N.D. Cal. 2012).

In *Beechum* the national bank made private student loans and sold those loans to the servicer within 90 days of loan disbursement. The servicer subsequently sold the loans to other parties. The servicer performed functions related to loan origination including marketing and serviced the loans after origination.

The plaintiffs alleged that the servicer was the "true creditor" of the loans because (i) the national bank had no risk of loss because the servicer provided funds for the loans and agreed to purchase the loans in advance, (ii) the servicer controlled all aspects of marketing and (iii) the servicer set the terms of the loans and determined the schools and students that were eligible for the loans. The plaintiffs argued that, because the servicer was the "true creditor," the private student loans did not fall under the statutory usury exemption for bank loans and so were usurious.

Citing two California appellate courts, the district court held that California law requires the court to look solely at the form of the transaction when analyzing whether loans are exempt from California's usury prohibition. According to the court, the program agreement indicated that the national bank was the source of the loan funds insofar as (i) the loans were disbursed from an account belonging to the national bank and (ii) the national bank was required to repay any amount advanced by the servicer to fund loans. Thus, the national bank issued the loans and the loans qualified for the statutory exemption from California's usury prohibition.

The *Beechum* court distinguished usury cases cited by the plaintiffs in support of plaintiffs' contention that courts must look at the substance of a transaction. Those usury cases, the court said, focused on (i) whether a party intended to enter into a usurious transaction (an essential element of a usury claim) and (ii) whether a common law exemption to California's usury prohibition applied. In contrast, the question in *Beechum* is whether the transaction fell within a statutory exemption to usury. The district court agreed with other California appellate courts that the function of statutory exemptions generally is to curtail inquiries into the underlying transactions (*i.e.*, "substance over form" analyses).

The court also characterized *Ubaldi* as irrelevant insofar as *Ubaldi* (i) did not involve a usury claim and (ii) largely concerned preemption under the National Bank Act. Because the private student loans qualified for the usury exception for bank loans, the *Beechum* court did not analyze whether the usury claims were preempted by the National Bank Act.

Finally, in a footnote, the court justified its ruling based on public policy. According to California courts, the purpose of the bank usury exemption is to facilitate a bank's sale of loans in the secondary market. Subjecting nonbank purchasers of bank loans (like the servicer) to California's usury limit would make these entities less inclined to purchase loans, which is contrary to the purpose of the exemption.

The *Beechum* case comes less than a month after the same district court (but a different judge) applied a "predominant economic interest" test to find that a servicer was the "true creditor" in a tribal lending program and engaged in deceptive acts or practices under the federal Consumer Financial Protection Act. *See Consumer Financial Protection Bureau v. CashCall*, No. 15-7522, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016) and our ALERT of Sept. 9, 2016.

As "true creditor" case law continues to evolve, we can provide advice on how programs can be structured and operated to minimize the risk of "true creditor" challenges. ❑

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