

Clients & Friends Memo

Marketplace Lending Update #3: Kabbage Heads to Court

May 10, 2018

A recently filed California lawsuit raises the stakes in the ongoing challenge to the “bank origination model.” The lawsuit, *Barnabas Clothing, Inc. v. Kabbage, Inc.*, was filed on March 22, 2018 in Superior Court in Los Angeles and recently removed to the federal court.¹ Barnabas alleges violations of state usury, false advertising, and unfair competition laws, and asserts two federal Racketeer Influenced and Corrupt Organizations (“RICO”) Act claims. Barnabas seeks to certify a class on behalf of all California-based Kabbage borrowers and requests various relief, including that the court void the Kabbage loans.

The presumptive lead plaintiff is a clothing retailer, Barnabas Clothing.² Barnabas Clothing took out five loans from Kabbage, each designated as a six-month term loan. Barnabas claims the marketing materials accompanying these loans solicited borrowers by promising they could repay a six-month loan with monthly installments of one-sixth of the total loan, plus monthly fees. Barnabas alleges that the loan agreement created a different schedule, however—a schedule that front-loads interest so that borrowers’ payments primarily service interest on prior loans rather than principal.

Barnabas alleges that Kabbage “aggressively markets, underwrites, and services short-term loans to struggling small businesses” that “often substantially exceed California’s maximum legal interest rate.” According to the complaint, Kabbage shields its activities from California usury laws by entering into an arrangement with Celtic Bank, a Utah-chartered bank able to “export” the rate of interest allowed under Utah law—which permits any rate agreed upon. Barnabas contends that, under the Kabbage loan agreements, Kabbage originates, underwrites, and funds the loans. Then, Barnabas alleges, Kabbage “enters into sham transactions with Celtic Bank, which acts as the lender in name only,” in order to circumvent California usury laws. Barnabas characterizes this relationship between Kabbage and Celtic Bank as an illegal “rent-a-bank scheme” and levels two federal racketeering claims against the two entities.

¹ *Barnabas Clothing, Inc. et al. v. Kabbage, Inc. et al.*, No. 18-3414 (C.D. Cal. filed Apr. 24, 2018). As of publication, Plaintiffs have not moved to remand to state court—unsurprisingly, given the federal RICO claims alleged.

² Barnabas and the other named plaintiff, Alexander Aquino, are represented by Benesch, Friedlander, Coplan & Aronoff LLP; White and Williams, LLP; and Marlin & Saltzman LLP.

The two California courts (both federal) that examined the “bank origination model” reached seemingly opposite conclusions. In *Beechum et al. v. Navient Solutions, Inc. et al.*,³ the court upheld a loan program in which student loans were originated through Stillwater National Bank & Trust Co. The court analyzed the “face of the transactions,” and concluded that the bank was the true lender because it originated the loans as a matter of fact. In *Consumer Financial Protection Bureau v. Cash Call, Inc.*,⁴ however, a case decided in the same district only three weeks earlier, the court granted summary judgment to the CFPB in a lawsuit against Cash Call, an alleged payday lender. The court disregarded that the loans were originated by a tribal entity exempt from usury restrictions, and instead determined that Cash Call was in fact the “true lender” and that the Cash Call loans were therefore void and uncollectible.

Kabbage recently moved to compel arbitration of this dispute (and to stay the federal case pending arbitration), relying on the loan agreements’ class-waiving arbitration clause. The court is scheduled to hear arguments on the motion to compel arbitration on June 18. If the case avoids arbitration, Judge Philip Gutierrez will have the opportunity to seek to reconcile his colleagues’ seemingly conflicting decisions in *Beechum* and *Cash Call*.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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³ No. 15-8239, 2016 WL 5340454 (C.D. Cal. Sept. 20, 2016).

⁴ No. 15-7522, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016).