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Marketplace Lending Update #2: Another Rocky Mountain Remand

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Clients & Friends Memos

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In our prior Clients & Friends Memo "Who's My Lender?" published on March 14, 2018, we analyzed two actions brought against marketplace lenders, one against Kabbage Inc. ("Kabbage") in federal court in Massachusetts[1] and the other against Avant in federal court in Colorado.[2] In that memo, we noted that the Massachusetts action against Kabbage is proceeding to arbitration, while the action against Avant was remanded to state court.

Last week, Colorado courts issued several new rulings related to marketplace lending. First, the federal court in Colorado remanded another enforcement action brought by the Administrator of the Colorado Consumer Credit Code against Marlette Funding ("Marlette"),[3] which had been doing business as a marketplace lender in Colorado under the name Best Egg. Following the reasoning in the *Avant* decision discussed in our prior memo, the court rejected the marketplace lender's argument that Colorado's usury laws were subject to complete preemption under federal law and therefore the court granted plaintiff's motion to remand. As a result, Avant and Marlette will be forced to make their arguments that a bank is the "true lender" and that the Colorado Administrator's usury claims are therefore preempted by federal

law, and any other defenses, in Colorado state court.

Second, the federal court dismissed two parallel actions brought to halt the state court proceedings. In separate actions, WebBank and Cross River Bank,[4] the banks that partner with Avant and Marlette, each attempted to prevent the enforcement actions from moving forward by filing actions in federal court seeking (1) a declaratory judgment that Section 27 of the Federal Deposit Insurance Act ("FDIA") expressly preempts Colorado usury laws as to loans originated by WebBank and Cross River, and (2) a permanent injunction against Colorado barring its enforcement of usury laws against the banks or any party associated with loans they originated. Because the enforcements actions against Avant and Marlette had been remanded, the courts held that the *Younger* abstention doctrine, as articulated by the Supreme Court in *Younger v. Harris*,[5] applied to these challenges, and dismissed the banks' challenges to the state's enforcement powers. The *Younger* abstention doctrine bars federal courts from hearing claims that are subject to concurrent administrative proceedings initiated by a state agency, among others.

In reaching this conclusion, the courts found that the requirements for *Younger* abstention were met[6] and rejected each of WebBank's and Cross River's arguments as to why the doctrine should not apply. The banks contended that: (1) they were not parties to the Avant and Marlette actions and were not an alter egos of the non-bank finance companies; (2) the *Younger* doctrine did not apply to the Avant or Marlette actions because they are enforcement actions; and (3) preemption under Section 27 of the FDIA is "facially conclusive" such that no state interest would be served by allowing the state court to act.

In rejecting these arguments, the courts wrote that although WebBank and Cross River are not parties to the related cases, they also are not strangers to the enforcement actions because they "[have] a close business relationship with Avant [and Marlette]" and their "mutual interests go beyond merely opposing the same policy . . . [seeking] to vindicate the same conduct that is at issue in the enforcement action[s]." The Court also found that *Younger* abstention applies to civil enforcement actions and that, even if a "facially conclusive" exception to *Younger* did exist, as WebBank and Cross River had argued, they made no showing that it would apply to the facts of these cases.

Considered alongside the remand of the state enforcement actions against Avant and Marlette, the federal court's rejection of WebBank and Cross River's challenges to the state's enforcement powers is notable. Unlike many prior marketplace lending cases, the litigants were represented by nationally renowned law firms and supported by national trade groups as *amici*. These recent rulings illustrate the risks that persist in some states for marketplace lenders utilizing the bank origination model. We will continue to closely monitor these developments.

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1 *NRO Boston LLC and Indelicato v. Kabbage Inc. and Celtic Bank Corp.*, No. 17-cv-11976 (D. Mass. Oct. 12, 2017).

2 *Meade v. Avant of Colorado LLC*, No. 17-cv-620 (D. Col. Mar. 9, 2017).

3 *Meade v. Marlette Funding*, No. 17-cv-575 (D. Col. Mar. 3, 2017).

4 *WebBank v. Meade*, No. 17-cv-786 (D. Col. Mar. 28, 2017); *Cross River Bank v. Meade*, No. 17-cv-832 (D. Col. Apr. 3, 2017).

5 401 U.S. 37 (1971).

6 The courts found that the enforcement action was pending in state court, it implicated an important state interest, and there was no showing that Avant or Marlette would not be able to raise their preemption challenges in state court. *See WebBank* at pp. 4-5; *Cross River* at pp. 4-5.

Jonathan Watkins and Chris Gavin contributed to this article.