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Strategic Options and Legal Risks for Elite ReFi, Inc.

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Memorandum

DATE: June 2020
TO: Associate Team
FROM: Partner, XYZ Law LLP
RE: Strategic Options and Legal Risks for Elite ReFi, Inc.

I received a call last night from Katie Harris, the former associate who left our team two weeks ago to become the first general counsel of Elite ReFi, Inc. (***ReFi***). As you will recall from Katie's goodbye dinner, ReFi is a socially-responsible marketplace lender that operates an online platform for the refinancing of student loans. I am going to be on a plane for most of the day, but can chat with you this evening right before we have a face-to-face meeting with ReFi's general counsel and senior management. I'll be coming directly from the airport, so let's meet at the coffee shop across the street from Elite ReFi's offices about a half hour before the meeting. Representatives of Finventures Capital Group LLP (***Finventures***), a small Fintech-focused investment fund and current investor in ReFi, and RedRock LLP (***RedRock***), a large private equity fund considering investing in ReFi, will be at the meeting as well. We are under some time pressure and the budget is tight.

What follows are my quick notes from my call with ReFi's general counsel. Don't be afraid to point anything out that you think I might have gotten wrong – I jotted these down in haste while on the call and haven't had the time to review.

ReFi offers student loan refinancing nationwide, but only to those with a graduate professional degree (e.g. M.D., J.D., M.B.A., or D.M.D.) and who are currently employed in their professional field. ReFi takes advantage of the fact that many federal student loans to graduate students in

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recent years carried higher than market interest rates, with the result that refinancing can lower the interest rate on student loans for this target demographic. ReFi also offers the option to stretch out payments.

ReFi suddenly grew much more quickly than anticipated after their much larger competitor suffered both platform issues and a scandal around whether its algorithm contained racial bias and was shut down for several weeks. Accordingly, most of ReFi's management's attention in the past year has been on making sure that its online platform remained operational in light of the increased traffic.

Given its success with the graduate professional demographic, ReFi has decided to begin offering student loan refinancing to those with undergraduate computer science and certain other undergraduate STEM degrees. ReFi's premise is that it will continue to work only with those who are currently employed in their field and with respect to whom ReFi's algorithm signals a very low default risk.

Opening up the platform to this wider pool will require additional funding. Finventures was an early investor in ReFi and has been quite pleased with the recent unexpected growth. As a result, Finventures recently participated in a new round of financing for ReFi, realizing that further investment will soon be needed. The funds from the recent round have not yet been deployed, but as a business matter they must be soon. ReFi has hired a consulting firm (***McBain***) and a boutique investment bank (***ZerpBank***) to evaluate its options for deploying the recent round and to help it find additional investors. One of these potential additional investors is RedRock, a large private equity fund.

ReFi was started by several graduate students only three years ago who originally operated it part-time. The company's budget for legal services has been very slim – in the beginning, ReFi's founders relied upon part-time help from their law school classmates. Once the company took off, ReFi hired a retired lawyer who had specialized in securitization to advise on the impacts of the Second Circuit's decision in *Madden v. Midland Funding, LLC*[1] and recent true lender litigation for ReFi's business model. That lawyer, who in retirement was operating as a solo practitioner, delivered ReFi a memorandum adopting the view that the *Madden* case and true lender cases are limited in application strictly to their facts and apply only to debt collectors and other predatory lenders, like payday lenders. Because of its tight legal budget, ReFi did not revisit that advice over the past three years, instead relying on updates from general news, its investment bankers, and informal discussions with consultants. The memorandum was made available to Finventures when it did its diligence during its investment rounds and has been made available to RedRock.

In light of its recent growth, and after discussions with its investors, ReFi and its founders realized that they had reached the stage where they needed in-house counsel and compliance capabilities. They hired Katie Harris, our former associate, as their first general counsel the week after the last

[1] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S. Ct. 2505 (2016). Attached as Appendix I.

financing from Finventures closed. Upon reviewing the three-year-old memorandum analyzing the implications of *Madden* and the true lender cases, one of her first actions as general counsel was to suggest the memorandum's analysis was out of date and might have always underestimated the legal risks that *Madden* and the true lender cases present to ReFi's business model. Finventures and the founder management are convinced that the new general counsel is overstating the risks.

ReFi, Finventures, and RedRock have decided to split the cost of hiring us. They all seek our views on the risks that *Madden* and the true lender cases pose to ReFi's business model. We may need to set up a call with our general counsel's office here at XYZ Law LLP to make sure they don't see any problems with this arrangement.

McBain and ZerpBank have already prepared a slide deck with strategic expansion options for ReFi, a copy of which has been given to us to help speed along our analysis and which is attached as Appendix II.[2] I flipped through this quickly and noticed a few things we will need to think carefully about.

ReFi's Business

ReFi was incorporated in Delaware in 2016 and operates an online marketplace lending website specializing in the refinancing of student loans. ReFi is a strong proponent of responsible lending and has adopted a range of internal policies and practices in order to facilitate greater access to student loan refinancing in a manner informed by a holistic understanding of customers' present and ongoing ability to repay.

Customers interested in refinancing their student loans submit an application through ReFi's online platform, which is open to customers nationwide. A decision on whether or not to approve the application for refinancing is made on the basis of the information provided in the customer's application and on ReFi's internal proprietary data analytics and credit assessment tools. ReFi does not itself extend credit to the relevant customer, which would subject ReFi to state and federal regulatory burdens, such as the need to obtain state lending licenses and to comply with state usury laws, which would limit on a state-by-state basis the interest rates ReFi can charge. Instead, once an application has been approved, the refinanced loan is originated by Elite ReFi's partner bank, Squarestream, a state-chartered digital bank that specializes in being a bank partner to market place lenders. Elite ReFi has just renegotiated an exclusive 3-year contract with Squarestream at very favorable pricing. Squarestream is not subject to any limit on the interest rates they charge.

The loans approved through ReFi's marketplace lending platform and originated by Squarestream do not remain on the banks' books. In fact, the bank immediately sells 100% of the loans to ReFi.

[2] McBain and ZerpBank, STRATEGIC EXPANSION OPTIONS: ELITE REFI. Attached as Appendix II.

In the past, ReFi has relied on equity capital to finance these purchases. However, in order to maximize the availability of refinancing through its platform, and thereby also maximize the commission-based revenue it earns through the platform, ReFi also on-sells the loans to fixed income investors. ReFi has employed a range of funding models in this regard, including selling whole loans to institutional investors, securitizing loans, and selling pass-through interests in loans to retail investors under a peer-to-peer lending program.[3]

This bank partnership model was critical in ReFi's expansion over the past three years. It allowed ReFi to provide uniform and advantageous interest rates nationwide as interpreted by the Supreme Court's *Marquette* decision and 12 U.S.C. §85, which allows a federally-chartered bank headquartered in one state to charge interest on any loan at the rate allowed by the laws of the state in which it is headquartered.[4] A similar provision applies to state-chartered banks.[5] Together, by the operation of federal preemption, these provisions allow a bank to export interest rates which are permissible based on the location of the bank's headquarters or the state in which it is chartered, even when transacting with customers in states where such rates would not be permissible were the bank located or chartered there. This ability to export rates throughout the country is particularly important given that usury laws, which set the maximum rate of interest that lenders may charge on consumer loans, vary substantially from state to state.

As understood during ReFi's operations to date, the ability of Squarestream to export rates permissible based on the location of their headquarters not only ensured the validity of refinancing loans when initially originated by those banks, but also ensured their ongoing validity and enforceability in the hands of subsequent assignees of the loans, including ReFi and the third parties to whom ReFi sells the loans. Given the funding sources relied on by ReFi, these legal features of ReFi's bank-partnership business model have been crucial to the company's operations and expansion.

Sources of Legal Risk

In the same three-year period in which ReFi rapidly expanded its nationwide operations, there were a series of legal developments challenging the above-described traditional understanding of rate exportation and preemption of state usury laws. We've done work in this area before, so I've pulled together this summary based on a past memorandum. I have summarized the main sources of legal risk I would like you to consider. I have also attached to this Memo as Appendices some of the relevant materials, and as Appendix VI a legal memorandum we prepared for another client which considers these legal risks in detail.[6] Note: This work was carefully vetted by a

[3] **Note:** Students do not need to consider any securities law issues associated with these funding sources.
[4] 12 U.S.C. § 85; *Marquette Nat'l Bank v. First Omaha Serv. Corp.,* 439 U.S. 299 (1978).
[5] 12 U.S.C. § 1831d(a).
[6] Randall D. Guynn, Jai R. Massari & Margaret E. Tahyar, DAVISPOLK FINREG, MEMORANDUM FOR MARKETPLACE LENDING ASSOCIATION, "*Federal Banking Regulators Can and Should Resolve Madden and True Lender Developments*," Aug. 14, 2018, *https://www.finregreform.com/single-post/2018/08/14/federal-banking-regulators-can-resolve-madden-true-lender-developments/*. Attached as Appendix VI.

number of partners, so you should consider it a reliable reference when working through my rough summary below.

I – The valid-when-made doctrine and Madden v. Midland Funding

The traditional understanding of rate exportation and preemption of state usury laws alluded to above is an application of the valid-when-made doctrine. The valid-when-made doctrine provides that a loan that is valid at its inception cannot become usurious upon subsequent sale or transfer to another person. This doctrine is one of long standing, having been recognized by the Supreme Court as early as 1828.[7] Indeed, in 1833, the Supreme Court described as a cardinal rule the proposition "that a contract, which, in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction."[8]

Application of the valid-when-made doctrine to ReFi's bank-partnership model would indicate that because of the ability of Squarestream under federal statute to charge interest rates permissible based on the location of its headquarters, any loan originated by it should be valid and not subject to challenge under conflicting state usury laws when in the hands of a subsequent non-bank purchaser or assignee. Notwithstanding the valid-when-made doctrine, recent legal developments have cast doubt on the enforceability of out-of-state interest rates in the hands of non-bank loan purchasers and assignees. In particular, the decision of the United States Court of Appeals for the Second Circuit in *Madden v. Midland Funding, LLC* has generated much uncertainty in the ongoing application of the valid when made doctrine.[9]

The plaintiff in that case, Saliha Madden, was a New York resident who opened a credit card account with Bank of America, a national bank.[10] In 2005, Madden's account was sold to another national bank, which later charged off the account as uncollectible, before itself selling the account to Midland Funding.[11] Through an affiliate, Midland Funding sought to collect Madden's debt at an interest rate of 27% per year, which was the rate chargeable pursuant to the terms of the credit card agreement with Bank of America.[12] Madden filed suit in the Federal District Court against Midland Funding and its affiliate, alleging a violation of New York's state usury law, which imposed a maximum interest rate of 25%.[13]

Judge Seibel in the United States District Court for the Southern District of New York held that because the underlying credit card loan was originated by a national bank, the National Bank Act preempted state usury law.[14] Citing authority from the Fifth and Eighth Circuits,[15] Judge Seibel

[7] Gaither v. Farmers & Mechs. Bank of Georgetown, 26 U.S. (1 Pet.) 37, 43 (1828).
[8] *Nichols v. Fearson*, 32 U.S. (7 Pet.) 103, 109 (1833).
[9] *Madden, supra* Note 1.
[10] *Id.* 247.
[11] *Id.* 248.
[12] *Id.*
[13] *Id.*
[14] *See* Petition for a Writ of Certiorari, *Midland Funding, LLC v. Madden,* No. 15-610.
[15] *Id.* 8; *See, e.g., Phipps v. FDIC,* 417 F.3d 1006, 1013 (8th Cir. 2005).

reasoned that when examining the application of National Bank Act preemption in the context of loan assignments, courts look at the originating bank and not the subsequent assignee.[16]

On appeal, the United States Court of Appeals for the Second Circuit reversed, holding that the National Bank Act did not preempt Madden's state usury law claim because Midland Funding and its affiliates were not national banks, subsidiaries or agents of a national bank, or acting on behalf of a national bank, and thus were not entitled to the protection of National Bank Act preemption.[17] In so concluding, the Second Circuit did not analyze or address the valid-when-made doctrine.

Midland Funding petitioned for a writ of certiorari on the question whether the National Bank Act "continues to have preemptive effect after the national bank has sold or otherwise assigned the loan to another entity."[18] Midland Funding argued in its petition that the Second Circuit's decision was erroneous because it "allows state law to infringe the core enumerated power of national banks to set interest rates at the level allowed by their home States."[19] In this regard, Midland Funding argued that 12 U.S.C. §85 "incorporates the principle that an interest rate set by an originating bank cannot be invalidated by a subsequent assignment of the loan" and that "[t]he valid when made doctrine is essential to a national bank's ability to set interest rates."[20] Midland Funding further argued that the Second Circuit erred in failing to take into account the broader preemption by 12 U.S.C. §25b of state consumer financial laws that prevent or significantly interfere with the ability of national banks to exercise their powers.[21] Various amicus briefs were filed in support of Midland Fund's petition for certiorari, including by industry groups such as the American Bankers' Association. On the Supreme Court's invitation, an amicus brief was filed by the Solicitor-General and the Office of the Comptroller of the Currency expressing the views of the United States. Although that brief characterized the Second Circuit's decision as "incorrect," including its failure to consider the valid-when-made doctrine, it described the case as a poor vehicle for resolution of the application of National Bank Act preemption to state usury law claims against a subsequent assignee.[22] The Supreme Court ultimately denied Midland Funding's petition for a writ of certiorari.

As a decision of the Second Circuit, *Madden* is binding only in Connecticut, New York, and Vermont. However, it appears that the reasoning in *Madden* is influencing courts in other parts of the country. For example, *Madden* was cited by Chief Judge Castillo in the Northern District of

[16] *See* Petition for a Writ of Certiorari, *Midland Funding, LLC v. Madden,* at 8.
[17] *Madden v. Midland Funding, LLC*, 786 F.3d 246, 249-253 (2d Cir. 2015).
[18] Petition for a Writ of Certiorari, *Midland Funding, LLC v. Madden,* at 2.
[19] Id. 15.
[20] Id. 16.
[21] Id. 17.
[22] Brief for the United States as Amicus Curiae, Midland Funding, LLC v. Madden, No. 15-610.

Illinois in reasoning that National Bank Act preemption did not apply and thus denying a motion to dismiss a state usury law action.[23][24]

We need to think about the potential legal risks for ReFi's business model and funding sources as a result of the *Madden* decision.

II – True lender developments

A further legal development posing potential risks to ReFi's business model is the emergence of "true lender" analyses under which courts have exhibited a willingness to look through bank-partnership arrangements and characterize nonbank partners as the true lender on loans in form originated by the bank partner. Courts applying this theory have increasingly applied a "predominant economic interest" test in determining whether a bank or its nonbank partner is the true lender in a particular transaction.

In *Consumer Financial Protection Bureau v. CashCall*, *Inc*., attached to this Memo as Appendix IV,[25] the United States District Court for the Central District of California applied the true lender approach to a "tribal model" of lending. The defendant in that case, CashCall, was a Californian corporation operating in the payday lending industry. In 2006, in order to expand its operations beyond California, CashCall entered into partnerships with two banks under which loans were originated by the partner banks but then purchased from the banks and serviced on an ongoing basis by CashCall.[26] This bank partnership model was intended to take advantage of the pre-*Madden* understanding of federal preemption of state usury law claims against subsequent assignees of bank originated loans.

After CashCall's bank partners withdrew from this arrangement, CashCall entered into an agreement with Western Sky Financial, a South Dakota limited liability company formed by a member of the Cheyenne River Sioux Tribe (***CRST***) and licensed to do business by the CSRT.[27] Under the agreement, CashCall was under an obligation to purchase loans originated under the name of Western Sky Financial, with the proceeds from these purchases funding the origination of further loans.[28] Loans applications were originally made through CashCall agents, or through a Western Sky website hosted on CashCall's servers in California.[29] As the partnership continued, Western Sky loan agents employed on the CSRT reservation handled an increasing amount of calls

[23] *Eul v. Transworld Systems, Inc.*, 2017 WL 1178537 (N.D. Ill. Mar. 30, 2017).
[24] *OCC*, Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred, May 29, 2020 (pending publication in the Federal Register). Attached as Appendix III.
[25] *Consumer Financial Protection Bureau v. CashCall*, *Inc.*, No. CV 15-7522-JFW (RAOx), 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016). Attached as Appendix IV.
[26] *Id.* *1.
[27] *Id.* *2.
[28] *Id.*
[29] *Id.* *3.

from prospective borrowers.[30] At all times, the loan agreement for loans originated under this partnership identified Western Sky Financial as the lender.

In March 2014, the Consumer Financial Protection Bureau (***CFPB***) initiated proceedings alleging that CashCall had engaged in unfair, deceptive, and abusive acts and practices in violation of the Consumer Financial Protection Act of 2010 by servicing and collecting on loans that were wholly or partially void or uncollectible under state licensing and usury laws.[31] In granting the CFPB's motion for partial summary judgment, Judge Walter agreed with the CFPB's contention that in order to identify the "true lender" under the loans, one "should consider the substance, not the form, of the transaction."[32] The Court explained that "[i]n identifying the true or de facto lender, courts generally consider the totality of the circumstances and apply a predominant economic interest [test], which examines which party or entity has the predominant economic interest in the transaction."[33] Judge Walter ultimately concluded that CashCall, and not Western Sky Financial, was the true lender, emphasizing that it was CashCall that placed its money at risk, that CashCall purchased each and every loan before any payment was made, and kept enough money on deposit with Western Sky Financial to fund two days of loans at any one time.[34] Judge Walter went on to conclude that the CFPB had established that the loans were void or uncollectible under the laws of most borrowers' states, and that CashCall, as the true lender on the loans, had therefore engaged in violations of the Consumer Financial Protection Act.[35]

Courts in New York,[36] West Virginia,[37] and Maryland[38] have applied the true lender theory to look through the bank partnership model in the payday lending context. Further, in a number of states, plaintiffs and regulators are now invoking the true lender theory in relation to marketplace lenders and other non-payday lenders that rely on the bank partnership model.[39] In Georgia, the true lender theory applies, at least in the payday lending context, as a matter of statute.[40]

We need to think about the potential risk of ReFi being deemed the true lender on loans originated through the platform.[41]

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[30] *Id.*
[31] *Id.* *4.
[32] *Id.* *5.

[33] *Id.* *6 (internal quotation marks omitted).
[34] *Id.*
[35] *Id.* *9-*11.
[36] *People ex rel. Spitzer v. Cty. Bank of Rehoboth Beach, Del.*, 846 N.Y.S.2d 436 (2007).
[37] *CashCall, Inc. v. Morrissey*, No. 12-1274, 2014 WL 2404300 (W.Va. May 30, 2014).
[38] *CashCall, Inc. v. Maryland Comm'r of Fin. Reg.*, 139 A.3d 990 (Md. 2016).
[39] See, e.g., *Meade v. Marlette Funding, LLC*, No. 17-CV-00575-PAB-MJW, 2018 WL 1417706 (D. Colo. Mar. 12, 2018); *Meade v. Avant of Colo., LLC*, No. 17-CV-0620-WJM-STV, 2018 WL 1101672 (D. Colo. Mar. 1, 2018); *Indelicato v. Kabbage, Inc.*, No. 1:17- CV-11976 (D. Mass. Oct. 12, 2017).
[40] The Georgia Payday Lending Law codified a predominant economic interest test to determine when a "purported agent shall be considered a de facto lender" for purposes of applying state usury laws to payday loans.
[41] **NOTE:** Students should focus on the true lender aspects of the reasoning in *Consumer Financial Protection Bureau v. CashCall, Inc.,* and the legal risk of Refi, rather than Squarestream, being deemed the "true lender" on loans originated through Refi's platform. Students need not focus on the choice of law issues analyzed in *Consumer Financial Protection Bureau v. CashCall, Inc.*

III – Choice of law issues

At present, the loan agreements for student loan refinancing approved through ReFi's platform and originated by Squarestream contain a provision identifying the law of Utah as the governing law of the contract. Along with the federal preemption and true lender developments discussed above, there is a further potential risk that, depending on a borrower's state of residence at the time their loan was originated and/or at the time proceedings are brought on the loan, a Court may decide not to uphold the choice of Utah law as the governing law of the loan agreement.

Under choice of law principles, courts generally apply the law of the state chosen by the parties to govern their contract.[42] However, there are limited circumstances in which the courts will not uphold the parties' choice of law, such as where application of the chosen law would be contrary to public policy of the forum state.[43] Some courts have taken the view that state usury law limits reflect fundamental matters of public policy, such that a loan that is non-usurious under the governing law of the loan agreement may not be enforced by courts in other states based on the usury law of those states.[44] However, analysis of this source of legal risk is outside the scope of our retainer and so you should not dwell on these choice of law issues.[45]

Expansion Options

As set out in the pitch deck contained in Appendix I, McBain and ZerpBank have identified a number of strategic expansion options for the company.[46]

ReFi was started by five friends who were unhappy with the refinancing options for their own student loans. One of them, now almost 30, was criminally charged with the use of a false ID in a bar when he was 20 and was required to perform community service. Two of the other founders are from emerging market countries which have recently been identified by the Federal government as the source of government-sanctioned cyberattacks. The new general counsel of ReFi has advised that, in light of these facts, obtaining a bank charter would be more than usually complex. Senior management has decided that it would take far too long and be too risky for ReFi to seek a bank charter at this time. That option is off the table for strategic consideration.

Option 1 – Continue expansion plans unabated; modify documentation to avoid risk

Under McBain and ZerpBank's Option 1, ReFi would work with Squarestream to preclude any *Madden* or true lender issues by amendment of the loan documentation. In particular, the loan

[42] *See, e.g.,* Restatement (Second) of Conflict of Laws § 187 (1971).
[43] *Id.*
[44] *See, e.g., Madden v. Midland Funding, LLC.,* 237 F.Supp.3d 130, 151 (S.D.N.Y. 2017) (Concluding that "to apply Delaware usury law would violate a fundamental public policy of the state of New York").
[45] **NOTE:** Students need not dwell on the choice of law issues, nor on whether the choice of Utah law as governing loan agreements originated under the Refi platform would be respected.
[46] **NOTE:** Students should not assume that all information contained in the pitch deck is accurate. Nor should students assume that the client has given the partner all of the facts or understands the interconnections between all of the facts.

agreement for student loan refinancing approved through the ReFi Platform and originated by Squarestream would be amended so that borrowers agree (a) not to challenge the loan as usurious notwithstanding any future assignment;[47] and (b) that Squarestream, and no other party, is the true lender under the loan.[48]

I have not entirely thought through whether this would actually work. Please look into whether we could draft some contractual language to circumvent state usury statutes and the true lender analysis.

Option 2 – Continue expansion plans unabated; risk reducing actions not needed

Under McBain and ZerpBank's Option 2, ReFi would leverage its recent influx of capital from Finventures and future financing rounds to fund aggressive expansion plans in order to take advantage of the favorable current market conditions and lack of direct competition. Given that ReFi is facilitating borrowers refinancing at lower rates and adheres to responsible lending practices, ReFi would proceed on the basis that it is less likely than other lenders to be the target of class actions or regulatory scrutiny. The legal risks impact the entire marketplace lending sector and ReFi is less impacted than others. Given that there has been an influx of capital that must be deployed, there is no choice but to proceed while accepting the legal risks.

In any event, the OCC and FDIC have recently released for comment a proposed regulatory fix, an example of which is attached as Appendix V.[49] McBain and Zerpbank have advised senior management that they are confident final rules will be adopted in the near future that will completely address the *Madden* and true lender issues.[50]

It is my concern that McBain and Zerpbank are overconfident. There has been quite a bit of media response to the proposed rules, representative examples of which are attached as Appendix VII,[51] so we need to think carefully about what we can predict about the likelihood that these proposals will be adopted and the scope of what they actually cover. I have not read the proposals in full, so we'll also need to double check that they actually address legal risks from the perspective of both *Madden* and true lender litigation.

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[47] *But cf.* New York Jurisprudence, 2d, Interest and Usury § 56 ("Usury is not a crime in itself or *malum in se*; it is merely *malum prohibitum*. Both as an offense against the laws and a defense in suits in court, it is dependent upon express statute, and in determining the rights and remedies of the parties to a usurious exaction of interest, reference must be made to the provisions of the statute involved . . . Lenders, with the money, have all the leverage; borrowers, in dire need of money, have none. Thus, the laws defining and prohibiting usury are intended to protect against a lender's overreaching."); *Trinity Fire Ins. Co. v. Kerrville Hotel Co.,* 103 S.W.2d 121, 128-129 (1937) ("[W]e have found no authority . . . which would sustain the proposition that estoppel against pleading usury may be worked by merely stating in the original instrument itself, which does not disclose the usury, that it constitutes the sole and only contract between the parties, or even by directly stating in such instrument that the contract is free from the taint of usury.").

[48] Recall that in *Cash Call,* Judge Walter agreed with the CFPB's contention that in order to identify the "true lender" under the loans, one "should consider the substance, not the form, of the transaction."

[49] Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64229 (proposed Nov. 21, 2019) (The OCC proposes to amend 12 CFR 7.4001 and 12 CFR 160.110 to provide that interest on a loan shall not be affected by the sale, assignment, or other transfer of the loan)(Attached as Appendix V.)

[50] **NOTE:** Students should assume the political and economic conditions in effect as of January 2020.

[51] *See* Appendix VII.

Option 3 – Expand strategically; take risk reducing actions

Under McBain and ZerpBank's Option 3, ReFi would seek to limit exposure to California, due to true lender risk, and to states within the Second Circuit, the most important of which commercially would be New York, due to the *Madden* decision. ReFi has, to date, been very active in both California and New York, which are key markets for student loan refinancing. Under this option, ReFi would limit itself to providing refinancing to customers who currently live in states whose laws remain true lender and *Madden* friendly. In this regard, ReFi will focus its expansion efforts on markets with growing STEM-focused workforces, such as Austin, Charlotte, Nashville, and Phoenix.

Assessing the Risks

Evaluate the legal risks and how they impact the needed business decisions from the perspectives of ReFi, Finventures, and RedRock.

Assume that you do not have access to the partner for further information until half an hour before the meeting with the general counsel and senior management of ReFi, and representatives of Finventures and Redrock. Consider how you will brief the partner and how you ought to handle the meeting.

While ReFi and its business are fictional, in evaluating the legal risks with respect to the business and its expansion, students should assume the political and economic conditions in effect as of June 2020.

Do not consider any securities law violations that might have occurred in the fundraising. For current purposes, assume that Finventures was responsible for its own diligence and is not interested in abandoning the investment.

Appendices

I. *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, 136 S.Ct. 2505 (2016).

II. McBain and ZerpBank – Strategic Expansion Options for Elite ReFi (Davis Polk deck).

III. *OCC*, Permissible Interest on Loans that are Sold, Assigned, or Otherwise Transferred, May 29, 2020 (pending publication in the Federal Register). *https://www.occ.gov/news-issuances/federal-register/2020/nr-occ-2020-71a.pdf*

IV. *Consumer Fin. Prot. Bureau v. CashCall, Inc.*, No. CV 15-7522-JFW (RAOx), 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016). *https://static.reuters.com/resources/media/editorial/20180411/cfpbvcashcall--SJopinion.pdf*.

V. Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred, 84 Fed. Reg. 64,229 (Nov. 21, 2019). *https://www.govinfo.gov/content/pkg/FR-2019-11-21/pdf/2019-25280.pdf*.

VI. Memorandum for Marketplace Lending Association – Federal Banking Regulators Can and Should Resolve Madden and True Lender Developments" (Aug. 14, 2018). *https://www.finregreform.com/wp-content/uploads/sites/32/2018/08/Madden-True-Lender-Federal-Regulatory-Fix-Whitepaper_Final.pdf*.

VII. Adverse Media Coverage:

1. Neal Haggerty, *OCC offers road map for banks to bypass 'Madden' ruling*, AMERICAN BANKER (Nov. 18, 2019), *https://www.americanbanker.com/news/occ-offers-roadmap-for-banks-to-bypass-madden-ruling*.
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5. Peter Conti-Brown, *Can fintech increase lending? How courts are undermining financial inclusion*, BROOKINGS CTR. ON REG. AND MKTS. (Apr. 16, 2019), *https://www.brookings.edu/research/can-fintech-increase-lending-how-courts-are-undermining-financial-inclusion/*.
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