Circuits split on lenders‘ loophole

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Two Virginia circuit judges have reached opposite conclusions on whether Virginia law offers a window for “small loan companies” to charge unlimited interest rates. ”In what one lender’s attorneys called a decision of far-reaching importance, a Richmond judge in January held that small loan companies are exempt from regulation under the Virginia Consumer Protection Act. Judge Theodore J. Markow later denied a motion for reconsideration of his interpretation of the law.But a Fairfax County judge said last month such an interpretation would thwart the evident intent of the General Assembly in regulating loan practices. Judge David Bernhard concluded the Assembly “created no such gap in Virginia law through which fraudulent actors may operate in a ‘wild west’ loan environment. ”Markow’s Jan.

22 decision is Commonwealth v. Allied Title Lending LLC (VLW 018-8-098).Bernhard’s Oct. 28 ruling came in Commonwealth v. NC Financial Solutions of Utah LLC (VLW 018-8-094).Allied Title caseVirginia Attorney General Mark R. Herring created a Predatory Lending Unit in 2016 as part of his office’s Consumer Protection Section. He said in 2015 that Virginia had earned a reputation as the “East Coast capital of predatory lending. ”In 2017, the predatory lending unit took aim at an open-end credit plan lender, Allied Title, doing business at 23 offices as “Allied Cash Advance. ” In a civil lawsuit, state lawyers accused the company of making illegal, unlicensed loans at 273.75 percent annual interest.Ruling on Allied’s demurrer, Markow said the state could go forward with claims of violation of the Virginia Consumer Finance Act, but the judge dismissed a claim under the VCPA.“The Court finds that the Company falls within an exclusion to the Act under Virginia Code 59.1-199(D) as a ‘small loan company,’” Markow wrote.That statute exempts from the VCPA “banks, savings institutions, credit unions, small loan companies, and insurance companies regulated and supervised by the State Corporation Commission or a comparable federal regulating body. ”State lawyers said the qualifying phrase at the end applies to “small loan companies. ”Markow disagreed. He said the “rule of the last antecedent” requires that qualifying words and phrases apply only to the last antecedent unless indicated otherwise. Therefore, the statute’s qualifying phrase applies only to “insurance companies,” which directly precedes it.Markow also rejected the state’s suggestion that “small loan company” refers only to licensed companies. The judge said courts are bound by the plain meaning of the language.The decision was an important one, said William H. Hurd and Siran S. Faulders of Richmond, who represented Allied

Title.“Companies that are subject to the VCPA can be exposed to substantial penalties for a wide variety of broadly-defined violations.Thus, the decision that small loan companies are exempt is expected to have a major impact on the regulatory landscape,” the lawyers wrote in an online essay posted March 6.The state was allowed to file an amended complaint in September and Allied filed another demurrer in response. The demurrer was pending at press time, according to court records.Bankruptcy court strategyConsumer protection lawyers also took aim at Allied Title in a bankruptcy action. An Allied borrower filed for bankruptcy and initiated an adversary proceeding in Richmond’s U.S. Bankruptcy Court, contending Allied Title’s loan violated Virginia consumer finance law. The borrower sought class action status.The bankruptcy judge looked for guidance from the Supreme Court of Virginia, but in an Aug. 31 order the Supreme Court said its rules did not allow for certification orders from bankruptcy courts.The same state lawyers who took Allied Title to court before Judge Markow sought to intervene in the bankruptcy court action, saying the legal issues, claims and defenses were identical. The motion to intervene and various other issues were pending before U.S. Bankruptcy Judge Kevin R. Huennekens as of press time.Net Credit caseThe Fairfax case involved a different loan company and a different type of loan. Instead of Allied Title’s bricks-and-mortar offices, Chicago-based Net Credit offered loans through its website. But Net Credit sought to use the same VCPA exemption for “small loan companies,” pointing to Markow’s ruling.Herring’s office sued in May, claiming Net Credit was charging interest rates of 34 to 155 percent, when the rate should be capped at 12 percent under the VCPA.The state’s suit also claimed Net Credit continued to collect loan payments after being notified that debtors had filed for bankruptcy. The suit said Net Credit relied on a Utah choice of law clause to avoid a cap on interest rates.“The choice of law clause is void because it violates Virginia’s longstanding public policy against usury and the purpose of Net Credit’s contracts with Virginians bears no reasonable relationship with Utah,” the suit alleged.Net Credit responded with a motion for change of venue and a demurrer. The case came to Judge Bernhard for a ruling. In a 31-page opinion, Bernhard denied the venue motion and overruled the demurrer.Net Credit is a Chicago-based internet lender that provided closed-end installment loans to more than 47,000 Virginia consumers at annual rates up to 155 percent, Bernhard said in his summary of the complaint.Net Credit’s position was that it need not be licensed by the State Corporation Commission to make consumer loans in Virginia and that it also is exempt from regulation of fraudulent conduct under the VCPA’s exemption for small loan companies.“In short, Defendant’s position is that there exists a gap in the statutory scheme where lenders engaging in fraud may operate with impunity, subject neither to regulatory supervision nor the disciplining balm of adjudication of VCPA claims in the courts,” Bernhard wrote.“This Court finds the General Assembly created no such gap in Virginia law through which fraudulent actors may operate in a ‘wild west’ loan environment, unfettered from regulatory supervision or court enforcement,” the judge continued.Bernhard said he found Markow’s Allied Title ruling unpersuasive and did his own analysis of the phrase “small loan companies. ” He said the Assembly had expressed the intent, dating back at least to 1918, that most financial institutions operating in Virginia either be licensed or otherwise regulated by appropriate laws.Parsing the language of the VCPA exemption, Bernhard said the qualifying phrase at the end refers to federal regulation, which would not apply to insurance companies. He concluded the qualifying phrase applied to all of the categories in the exemption, allowing no loophole for unlicensed loan companies.“The VCPA cannot be turned into an incongruity which thwarts the legislative intent that Defendant be regulated by the SCC or a comparable federal regulating body before gaining exemption from the VCPA,” Bernhard wrote.Venue proper in FairfaxNet Credit sought to move the case to Richmond Circuit Court, saying Fairfax did not have a “practical nexus” to the case. More customers live in the Richmond area than in Fairfax County, the company said.That “broad statement” was not enough to show good cause to transfer without identifying

witnesses who would be inconvenienced, Bernhard said.“While Net Credit claims Richmond is a more convenient forum, it has not met its burden to demonstrate good cause to transfer venue in this case,” the judge wrote. Bernhard also rejected application of the loan agreement’s choice of Utah law, even though two arbitrators in a separate case found that Utah law should apply under the loan agreement.Finally, Bernhard ruled the state had adequately pled misrepresentations in violation of the VCPA. The case continues.Net Credit is represented by Charles K. Seyfarth and other lawyers from his Richmond firm. Seyfarth declined comment.A spokesperson for the attorney general’s office did not respond to a request for comment by press time.Consumer lawyer Thomas Domonoske of Newport News one of the attorneys suing Allied Title in bankruptcy court said the interpretation of the “small loan company” exemption ultimately could turn on whether that language refers to a former designation in the “Small Loan Act,” now part of the state’s consumer finance statutes.

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