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14 **SUPERIOR COURT OF CALIFORNIA**
15 **SAN FRANCISCO COUNTY**

16 CHRISTIAN HELLUM; WILLIAM)
17 BARNWELL; AND DAVID BOOTH,)
18 individually and on behalf of all others)
19 similarly situated,)

20 Plaintiffs,)

21 vs.)

22 PROSPER MARKETPLACE, INC., a)
23 Delaware Corporation; CHRISTIAN)
24 LARSEN; ED GIEDGOWD; KIRK T.)
25 INGLIS; DOUG FULLER; JAMES W.)
26 BREYER; LARRY W. CHENG; PAUL M.)
27 HAZEN; ROBERT C. KAGLE; and JOHN)
28 AND JANE DOES 1-100,)

Defendants.)

ENCLOSED
Superior Court of California
County of San Francisco

NOV 20 2008

NOV 26 2008 BY: GORDON PARK-LI, Clerk
CRISTINA BAUTISTA
Deputy Clerk

CLASSIFICATION CONFERENCE SET

MAY 1 2009 - 9:00 AM

DEPARTMENT 212

CGC-08-482329

No.

CLASS ACTION

**COMPLAINT FOR VIOLATION
OF THE CALIFORNIA AND
FEDERAL SECURITIES LAWS**

DEMAND FOR JURY TRIAL

25 Plaintiffs Christian Hellum, William Barnwell and David Booth ("Plaintiffs"), by
26 and through their undersigned attorneys, allege, based upon personal knowledge as to
27 themselves and their own acts, and, as to other matters, based on information and belief
28 as follows:

1 1. This is a class action brought on behalf of all loan note purchasers in
2 defendant Prosper Marketplace Inc.'s ("Prosper" or the "Company") online lending
3 platform through Prosper's website www.Prosper.com from January 1, 2006 through
4 October 14, 2008 (the "Class Period").

5 2. Defendants Prosper, its CEO Christian Larsen ("Larsen"); its General
6 Counsel and Chief Compliance Officer Ed Giedgowd ("Giedgowd"); its Vice President of
7 Operations Doug Fuller ("Fuller"); and its Directors James W. Breyer ("Breyer"),
8 Larry W. Cheng ("Cheng"), Paul M. Hazen ("Hazen"); and John and Jane Does 1-100
9 ("Does") (Larsen, Giedgowd, Fuller, Breyer, Cheng, Hazen, and Does are collectively
10 referred to herein as the "Individual Defendants"; the Individual Defendants, Prosper, and
11 Does are collectively referred to herein as "Defendants") are liable to Plaintiffs under the
12 California and federal securities laws for offering and selling unqualified and unregistered
13 securities as follows:

14 (a) Pursuant to §§ 25110 and 25503 of the Code, Prosper is liable
15 because the loan notes it offered and sold to Class members in the State of
16 California were not qualified for sale in California and were not subject to
17 any exemptions under the Code;

18 (b) Pursuant to §§ 25210 and 25501.5 of the Code, Prosper is liable
19 because it was not a licensed broker-dealer for the loan notes it offered and
20 sold to Class Members in the State of California and were not subject to
21 any exemptions under the Code;

22 (c) Pursuant to § 25504 of the Code, the Individual Defendants are
23 liable as controlling persons of Prosper or for materially aiding Prosper's
24 violations of §§ 25110 and 25503 of the Code;

25 (d) Pursuant to Section 12(a)(1) of the Securities Act of 1933
26 ("Securities Act") Prosper is liable for offering and selling loan notes
27 without an effective registration statement, or valid exemption; and
28

1 (e) Pursuant to Section 15 of the Securities Act the Individual
2 Defendants are liable as controlling persons over Prosper who violated
3 section 12(a)(1) of the Securities Act.

4 3. Prosper is a privately held Delaware corporation, with its principal
5 executive offices located in San Francisco County. Prosper owns and operates an online
6 lending platform on its website, www.Prospcr.com. (the "Website" or "Marketplace").

7 4. Through the Website, Prosper purports to connect "lenders" and
8 "borrowers." Prosper's Marketplace works like a double-blind auction, connecting
9 "borrowers" who wish to borrow money, with "lenders," like Plaintiffs, who wish to
10 commit to purchase loans, in the form of loan notes, that have been extended to
11 borrowers.

12 5. Lenders and borrowers register on the Website and create Prosper
13 identities. Lenders are prohibited from disclosing their actual identifies anywhere on the
14 Website. Borrowers request three-year fixed-rate, unsecured loans in amounts between
15 \$1,000 and \$25,000 by posting "listing" on the Website indicating the amount they want
16 to borrow and the maximum interest rate they are willing to pay.

17 6. Prosper assigns borrowers a credit grade based on commercial credit score
18 obtained from a credit bureau, but Prosper does not verify personal information, such as
19 employment and income.

20 7. Potential lenders bid on funding all or portions of loans for specified
21 interest rates, which are typically higher than rates available from depository accounts at
22 financial institutions.

23 8. The Marketplace is open to the general public and there are no special
24 requirements to join the Marketplace.

25 9. After an auction closes and a loan is fully bid upon, the borrower receives
26 the requested loan with the interest rate fixed by Prosper at the lowest rate acceptable to
27 all winning bidders.

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1 10. Individual lenders do not actually lend money directly to the borrower,
2 rather, the borrower receives a loan from a bank with which Prosper has contracted.

3 11. Interests in the loan are then sold and assigned by Prosper to the lenders,
4 with each lender receiving an individual non-recourse promissory note.

5 12. In return, Prosper collects an origination fee from each borrower of one to
6 three percent of loan proceeds and collected servicing fees from each lender from loan
7 payments at an annual rate of one percent of the outstanding balance of the notes.
8 Prosper also administers the collection of loan payments from the borrower and the
9 distribution of such payments to the lenders.

10 13. Prosper initiates collection of past due loans from borrowers and assigns
11 delinquent loan accounts to collection agencies. Lenders and borrowers are prohibited
12 from transacting directly and are unable to learn each others' identities.

13 14. Since its inception in January 2006, Prosper has initiated approximately
14 \$174 million in loans.

15 15. As of October 2008, Prosper had over 830,000 members, which includes
16 both borrowers and lenders.

17 16. As of October, 2008 approximately \$21.7 million of loan notes purchased
18 by Class members have become worthless because the borrowers did not pay the loans to
19 Prosper. Additional loan notes will become worthless as more loans are charged off as
20 uncollectible.

21 17. The loan notes are securities within the meaning of the Code and the
22 Securities Act.

23 18. On November 24, 2008, the U.S. Securities Exchange Commission
24 ("SEC") issued an Order Instituting Cease-And-Desist Proceedings Pursuant to Section
25 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-And-Desist
26 Order (the "SEC Order"). The SEC made the following findings:
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- (a) The loan notes are securities within the meaning of the § 2(a) of the Securities Act;
- (b) Prosper violated § 5(a) because Proposer sold the loan notes, through interstate commerce, without an effective registration statement; and
- (c) Prosper violated § 5(c) of the Securities Act because Prosper sold and/or offered the loan notes, through interstate commerce, through the use or medium of any prospectus or otherwise, without a valid registration statement; and

19. The SEC Order also required that Prosper cease and desist from committing or causing any violations and any future violations of §§ 5(a) and (c) of the Securities Act.

20. A copy of the SEC Order is attached hereto as Exhibit A, and is incorporated as if fully set forth herein.

PARTIES

21. Plaintiff Christian Hellum, a resident of Los Angeles County, California purchased loan notes from Prosper and suffered damages.

22. Plaintiff William Barnwell, a resident of Piedmont, Alabama purchased loan notes from Prosper and suffered damages.

23. Plaintiff David Booth, a resident of Pompano Beach, Florida purchased loan notes from Prosper and suffered damages.

24. Prosper is a privately held Delaware corporation with its principal executive offices located at 111 Sutter Street, 22nd Floor, San Francisco, CA 94104. Prosper was previously incorporated as JC Capital Solutions, Inc. Prosper is in the business of effecting transactions in and offering and selling loan notes for itself and others.

1 25. Defendant Larsen was at all relevant times, and is, Prosper's Chief
2 Executive Officer and Co-Founder.

3 26. Defendant Giedgowd was at all relevant times, and is, Prosper's Chief
4 Compliance Officer and General Counsel.

5 27. Defendant Inglis was at all relevant times, and is, Prosper's Chief
6 Financial Officer.

7 28. Defendant Fuller was at all relevant times, and is, Prosper's Vice President
8 of Operations.

9 29. Defendant Breyer was at all relevant times, and is, a Director of Prosper.

10 30. Defendant Hazen was at all relevant times, and is, a Director of Prosper.

11 31. Defendant Cheng was at all relevant times, and is, a Director of Prosper.

12 32. Defendant Kagle was at all relevant times, and is, a Director of Prosper.

13 33. Plaintiffs do not know the true names and capacities of the defendants
14 sued herein as Does 1-100, inclusive, and therefore sue these defendants by such fictitious
15 names pursuant to Cal. Code. Civ. Proc. § 474. These defendants are the employees,
16 agents, affiliates, affiliated persons, professional practitioners, alter egos and/or
17 professional consultants of the Defendants, and the attorneys and others who participated
18 with them in the acts and conduct alleged in this Complaint and who had knowledge—or
19 reason to know—that their misconduct would cause Plaintiffs substantial financial
20 injury. Plaintiffs will seek leave to amend this Complaint to allege the true names and
21 capacities of these defendants when ascertained. Each of the fictitiously named
22 defendants caused, participated in, or aided and abetted the wrongful acts alleged in each
23 or some of the causes of action set forth below. The named defendants as well as the
24 fictitiously named Doe defendants are hereinafter collectively referred to as the
25 "Defendants."

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JURISDICTION AND VENUE

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2 34. Plaintiffs Cristian Hellum and William Barnwell purchased loan note
3 securities from defendant Prosper in San Francisco County, California. All of the
4 members of the proposed Class purchased loan notes from Prosper, through its Website,
5 in the State of California.

6 35. Venue is proper in this county because the vast majority of the conduct
7 and transactions giving rise to the violations of law complained of herein occurred in San
8 Francisco, California. Prosper is headquartered in San Francisco County, California, and
9 upon information and belief, its Website is maintained, in, or, from San Francisco
10 County, California. Thus, the transactions giving rise to Plaintiffs' claims occurred in
11 San Francisco, California.

12 36. This Court has jurisdiction over the California causes of action asserted in
13 this Complaint pursuant to the California Constitution, Article VI, §10, because this case
14 is a cause not given by statute to other trial courts.

15 37. The state securities law claims asserted herein arise under §§25110 and
16 25210 of the Code, and result in liability under §§ 25503, 25501.5, and 25504, of the
17 Code. The federal securities law claims herein arise under §§ 12(a)(1) and 15 of the
18 Securities Act, 15 U.S.C. §771(a)(1) and 77(o).

19 38. This Court has concurrent jurisdiction over the federal cause of action
20 asserted under §12(a)(1) of the Securities Act because federal courts do not have original
21 or exclusive jurisdiction over claims under the Securities Act, but rather share concurrent
22 jurisdiction with state courts, pursuant to §22(a) of the Securities Act.

23 39. In connection with the acts and course of conduct alleged in this
24 Complaint, defendants, directly and indirectly, used the means and instrumentalities of
25 interstate commerce, including the U.S. mails and interstate telephone communications.

26 40. This action cannot be removed to federal court under the Class Action
27 Fairness Act ("CAFA") pursuant to the Ninth Circuit Court of Appeals' decision in
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1 *Luther v. Countrywide Home Loans Servicing LP*, 553 F.3d 1031 (9th Cir. 2008) which
2 prohibits removal under CAFA of claims arising under the Securities Act of 1933.

3 41. This case is not removable to federal court under the Securities Litigation
4 Uniform Standards Act (“SLUSA”) because the loan notes are not publicly traded and are
5 not a “Covered Security” for purposes of Section 18 of the Securities Act of 1933 and
6 SEC Rule 146 promulgated thereunder.

7 **CLASS ALLEGATIONS**

8 42. The Class is so numerous that joinder of all members is impracticable.
9 The Marketplace has over 830,000 members and has sold over \$178 million in loan
10 notes, accordingly, there are tens of thousands, and perhaps hundreds of thousands, of
11 loan note purchasers that are class members.

12 43. There are questions of law and fact common to the class and which
13 predominate over any questions affecting only individual members of the Class. The
14 common questions include:

- 15 (a) Whether Prosper violated the Code by offering and selling
16 unqualified securities under the Code.
- 17 (b) Whether Prosper violated the Code by acting as a broker-dealer
18 in the securities transactions.
- 19 (c) Whether the Individual Defendants are liable as control persons
20 the Code.
- 21 (d) Whether Prosper violated the Securities Act by selling
22 unregistered securities.
- 23 (e) Whether the Individual Defendants and Does were controlling
24 persons of Prosper as defined by the Securities Act.
- 25 (f) The nature and extent of the relief to which Plaintiffs and the
26 Class are entitled under the Code and the Securities.
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1 61. This Cause of Action is asserted against the Individual Defendants (and
2 Does) under §25504 of the Code for Prosper's and (DOES) violations of §25110 and
3 §25503 of the Code.

4 62. Prosper and Does, acting through its executive officers and employees,
5 offered to sell and/or sold the loan notes to Plaintiffs and the Class in the State of
6 California. The loan notes were securities within the meaning the Code, and were
7 required to be qualified under § 25110 of the Code.

8 63. The loan notes were not subject to any exemption from qualification under
9 the Code. Prosper offered and sold the shares in California and Plaintiffs and the Class
10 purchased the loan notes in California.

11 64. The Individual Defendants are officers, directors, agents, affiliated
12 persons, employees of Prosper and Does and/or materially aided Prosper and Does in
13 offering and selling the loan notes to Plaintiffs and the Class.

14 65. Plaintiffs and the Class suffered damages as a result of Defendants'
15 violations. By reason of the foregoing, Prosper violated §25110 of the Code, and is liable
16 to Plaintiffs and the Class under §25503 of the Code.

17 66. The Individual Defendants and Does are liable to Plaintiffs and the Class
18 under §25504 of the Code for Prosper's and Does primary violations under §25110 and
19 §25503.

20 67. By reason of the foregoing, the Individual Defendants (and Does) are
21 jointly and severally required to restore all consideration paid for the loan notes, plus
22 interest at the legal rate, or damages.

23 68. Plaintiffs and the Class did not know, or in the exercise of due diligence
24 could not have known, or understood that the loan notes were required to qualified with
25 the Department of Corporations, until the SEC Order was issued.

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1 **THIRD CAUSE OF ACTION**

2 **Against Defendant Prosper (and Does) For**
3 **Violations of Cal. Corp. Code §§ 25210 and 25501.5**

4 69. Plaintiffs repeat and reallege each and every allegations in the foregoing
5 paragraph as if fully set forth herein.

6 70. This Cause of Action is asserted against Prosper (and Does) under
7 §§ 25210 and 25501.5, of the Code.

8 71. Prosper (and Does) were broker dealers within the meaning of the Code
9 because their primary business was effecting transactions in the loan notes, which are
10 securities, for their own account and/or for the account of Plaintiffs and the Class.

11 72. Prosper (and Does) violated § 25210 of the Code because none of them
12 were licensed broker-dealers with the Financial Industry Regulatory Authority, and upon
13 information and belief, did not have, during the Class Period, a broker-dealer certificate
14 from the Commissioner of the Department of Corporations.

15 73. Prosper (and Does) were not subject to any exemption from registration as
16 a broker/dealer or possession of a broker-dealer certificate under the Code or applicable
17 federal law.

18 74. By reason of the foregoing, Prosper (and Does) are required to restore to
19 Plaintiffs and the Class all consideration paid for the loan notes, plus interest at the legal
20 rate, or damages.

21 75. Plaintiffs and the Class did not know, or in the exercise of due diligence
22 could not have known, or understood that the Prosper (and Does) were not licensed
23 broker-dealers, did not have certificates issued by the Commissioner of the Department of
24 Corporations, or that such was required, until the SEC Order was issued.

1 **FIFTH CAUSE OF ACTION**

2 **Against the Individual Defendants (and Does)**
3 **For Violation of §15 of the Securities Act**

4 84. Plaintiffs repeat and reallege each and every allegations in the foregoing
5 paragraph as if fully set forth herein.

6 85. This Cause of Action is asserted against the Individual Defendants (and
7 Does) under §15 of the Securities Act.

8 86. For the reasons set forth above and pursuant to the Fourth Cause of
9 Action, Prosper (and Does) are liable to the Plaintiffs and the members of the Class under
10 § 12(a)(1) of the Securities Act.

11 87. The Individual Defendants (and Does) were control persons of Prosper by
12 virtue of, among other things, their positions as senior officers, directors and/or
13 controlling shareholders of the Company. Each was in a position to control and did in
14 fact control Prosper (and Does) and was responsible for ensuring that the loan notes were
15 sold to Plaintiffs and the Class pursuant to an effective registration statement.

16 88. None of the Individual Defendants made reasonable investigation or
17 possessed reasonable grounds for the belief that the loan notes were issued pursuant to an
18 effective registration statement. Had they exercised reasonable care, they could have
19 known of the loan notes were not sold or offered pursuant to an effective registration
20 statement.

21 89. Plaintiffs and the Class did not know, or in the exercise of due diligence
22 could not have known, or understood that the loan notes were required to be, or were not,
23 registered to an effective registration statement, until the SEC Order was issued.

24 90. This action was brought within one year after the discovery of the
25 §12(a)(1) violation and within three years after the date Plaintiffs purchased the loan
26 notes from Prosper.

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EXHIBIT A

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8984 / November 24, 2008

ADMINISTRATIVE PROCEEDING
File No. 3-13296

In the Matter of

PROSPER
MARKETPLACE, INC.,

Respondent.

**ORDER INSTITUTING CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, MAKING FINDINGS, AND
IMPOSING A CEASE-AND-DESIST
ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), against Prosper Marketplace, Inc. (“Prosper” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Respondent

Prosper is a Delaware corporation based in San Francisco, California, that owns and operates an online lending platform on its website, www.Prosper.com. Prosper was previously incorporated as JC Capital Solutions, Inc. ("JC Capital"). Prosper is a private corporation and is not registered with the Commission.

Summary

Prosper operates an online lending platform connecting borrowers with lenders. The loan notes issued by Prosper pursuant to this platform are securities and Prosper, from approximately January 2006 through October 14, 2008, violated Sections 5(a) and (c) of the Securities Act, which prohibit the offer or sale of securities without an effective registration statement or a valid exemption from registration.

Prosper's Platform

Prosper's lending platform functions like a double-blind auction, connecting individuals who wish to borrow money, or "borrowers," with individuals or institutions who wish to commit to purchase loans extended to borrowers, referred to on the platform as "lenders." Lenders and borrowers register on the website and create Prosper identities. They are prohibited from disclosing their actual identities anywhere on the Prosper website. Borrowers request three-year, fixed rate, unsecured loans in amounts between \$1,000 and \$25,000 by posting "listings" on the platform indicating the amount they want to borrow and the maximum interest rate they are willing to pay. Prosper assigns borrowers a credit grade based on a commercial credit score obtained from a credit bureau, but Prosper does not verify personal information, such as employment and income. Potential lenders bid on funding all or portions of loans for specified interest rates, which are typically higher than rates available from depository accounts at financial institutions. Each loan is usually funded with bids by multiple lenders. After an auction closes and a loan is fully bid upon, the borrower receives the requested loan with the interest rate fixed by Prosper at the lowest rate acceptable to all winning bidders. Individual lenders do not actually lend money directly to the borrower; rather, the borrower receives a loan from a bank with which Prosper has contracted. The interests in that loan are then sold and assigned through Prosper to the lenders, with each lender receiving an individual non-recourse promissory note.

Since the inception of its platform in January 2006, Prosper has initiated approximately \$174 million in loans. Prosper collects an origination fee from each borrower of one to three percent of loan proceeds and collects servicing fees from each lender from loan payments at an annual rate of one percent of the outstanding principal balance of the notes. Prosper administers the collection of loan payments from the borrower and the distribution of such payments to the

lenders. Prosper also initiates collection of past due loans from borrowers and assigns delinquent loan accounts to collection agencies. Lenders and borrowers are prohibited from transacting directly and are unable to learn each others' true identities.

Discussion

The notes offered by Prosper are investments. Lenders expect a profit on their investments in the form of interest, which is at a rate generally higher than that available from depository accounts at financial institutions. Prosper's website has included statements that the Prosper notes provide returns superior to those offered by alternative investments such as equity stocks, CDs and money markets. The Prosper website has also stated that it offers lenders ways to "spread your risk out and ensure a more reliable return" and describes how lenders are allowed to use payments from an outstanding loan to purchase a new loan "in order to maximize returns." In addition, marketing to institutional lenders on the Prosper website characterizes the platform as an alternative to "stock or bond returns" that is "crucial for prudent portfolio management" in "turbulent markets." Testimonials published on the Prosper website show that customers have used Prosper notes as investment vehicles. Prosper also offers Portfolio Plans that allow lenders to automatically bid on loans based on estimates of risk and return characterized by Prosper.

Lenders rely on the efforts of Prosper because Prosper's efforts are instrumental to realizing a return on the lenders' investments. Prosper lenders are effectively passive with respect to elements important to realizing profit on their investments and Prosper is instrumental in each of these elements. Prosper established and maintains the website platform, without which none of the loan transactions could be effected. Prosper provides mechanisms for attracting lenders and borrowers, facilitating the exchange of information between borrowers and lenders, coordinating bids, and effecting the loans. It provides borrower information to potential lenders via the loan listings, including credit ratings. Prosper provides a matrix for evaluating performance and potential returns in the form of historical loan performance, Prosper Marketplace and individual borrower performance, and delinquency activity, among other things. Prosper manages the bidding and subscription process for every loan and has the sole contractual right to service the loans, including administering the borrower and lender accounts, and providing monthly statements that reflect payments made and received on the loan notes, as well as amounts available for bidding on new notes.

Furthermore, under the terms of the notes, Prosper has the sole right to act as loan servicer of the notes. In this capacity, Prosper collects repayments of loans and interest, contacts delinquent borrowers for repayment, and reports loan payments and delinquencies to credit reporting agencies. Prosper also exclusively manages the process of referring delinquent loans to collection agencies for payment, and selling defaulted loans to debt purchasers. Since the lender does not know the borrower's identity, the lender would be unable in any event to pursue his or her rights as a noteholder in the event of default. Further, if a lender chooses to participate in Prosper's Portfolio Plan, whereby lenders are permitted to choose portfolios that automatically allocate the lender's funds among various loans based on risk and return characteristics categorized by Prosper, Prosper chooses the loans on which a bid is made. Lastly, the continued existence and operation of the Prosper platform is essential to the loan transactions taking place. Prosper lenders are too geographically diverse and diffuse to come together without Prosper.

They lack the requisite experience to run a loan auction or to create and service a loan package. Rather, the Prosper lenders rely on Prosper's continued operation of the platform in order to transact and to recoup any gain on their investments.

Legal Discussion

The notes offered by Prosper are securities pursuant to Section 2(a)(1) of the Securities Act and under the Supreme Court's decisions in both *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), and *Reves v. Ernst & Young, Inc.*, 494 U.S. 56 (1990).

A. Application of the *Howey* Investment Contract Analysis

Pursuant to *SEC v. W. J. Howey Co.*, 328 U.S. 293 (1946), an investment contract exists if there is present "an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301. An investment contract is a security under Section 2(a)(1) of the Securities Act, the offer or sale of which must be registered pursuant to Section 5 of the Securities Act.

The financial instrument offered by Prosper meets the definition of an investment contract as set forth in *Howey*. As discussed above, there is an investment of money when lenders invest money to purchase a loan. The lenders bear one-hundred percent of the risk of loss each time they fund a Prosper loan because the Prosper loans are non-recourse.

There is a common enterprise for several reasons. For example, a common enterprise exists because lenders and borrowers are dependent on Prosper in order to engage in new loans or to complete the timely repayment of loans already funded. A common enterprise also exists because the vast majority of Prosper loans are funded by more than one lender and because the majority of lenders fund more than one loan. All lenders would be negatively affected if Prosper were unable to operate the platform. In addition, there is a common enterprise between Prosper and its members because borrowers pay Prosper an origination fee of one to three percent of the loan, and each lender pays annual servicing fees to Prosper of one percent of the outstanding principal balance of the notes.

Further, lenders are dependent upon the efforts of Prosper to realize any return on their investment. As discussed above, borrowers and lenders are prohibited from transacting directly and must rely on Prosper to execute each element of the loan creation and repayment process.

B. Application of the *Reves* Note Analysis

A note is presumed to be a security under the Supreme Court's opinion in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), unless it is of a type specifically identified as a non-security. The types of non-security notes identified in *Reves* include notes delivered in a consumer financing; notes secured by a mortgage on a home; short-term notes secured by a lien on a small business or its assets; short-term notes evidenced by accounts receivable; notes evidencing "character" loans to bank customers; notes formalizing open account debts incurred in the ordinary course of business; and notes evidencing loans from commercial banks for ordinary operations. *Id.* at 65. A note that

is not among the list identified in *Reves* is a security unless it bears a “strong family resemblance” to the non-security notes identified in the opinion. *Id.* at 64-65. *Reves* established a four-part family resemblance test to determine whether a note is a security, which is comprised of the following factors: (i) the motivations of the buyer and seller; (ii) the plan of distribution; (iii) the reasonable expectations of the investing public; and (iv) the existence of an alternate regulatory regime. *Id.* at 66-67. If a note fails the family resemblance test, it is deemed a security and the offer or sale of such security must be registered pursuant to Section 5 of the Securities Act. The Prosper loan notes are securities under *Reves* because they do not fall into any of the enumerated categories of non-security notes, and they fail the family resemblance test.

With regard to the motivations of the buyer and seller, as discussed above, Prosper lenders are motivated by the desire to obtain a better return on their money than they otherwise could in another venue. While some Prosper lenders may be motivated, in part, by altruism, altruistic and profit motives are not mutually exclusive. See *In the Matter of Robin Bruce McNabb*, Rel. No. 34-43411 (Oct. 4, 2000), *aff’d*, 298 F.3d 1126 (9th Cir. 2002).

With respect to the plan of distribution, the Prosper notes are offered and sold on the internet to the public at large. There is no special level of financial sophistication or expertise that Prosper lenders must have. This wide dissemination and solicitation to the public with no attempt to limit investors is indicative of a security. See *Reves*, 494 U.S. at 68 (the notes “were... offered and sold to a broad segment of the public, and that is all we have held to be necessary to establish the requisite ‘common trading’ in an instrument”); *Pollack v. Laidlaw Holdings, Inc.*, 27 F.3d 808, 814 (2d Cir. 1994) (concluding that the broad-based, unrestricted sales to the general investing public supported a finding that mortgage participations were securities under federal securities laws).

In analyzing the expectations of the investing public, the lenders in this instance, the relevant issue is what a reasonable investor would believe about the character of the transaction, “even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not ‘securities’ as used in that transaction.” *Reves*, 494 U.S. at 66. The manner in which a transaction is characterized in advertisements is illustrative, and whether there is a “valuable return on an investment, which undoubtedly includes interest.” *Id.* at 69. As discussed above, Prosper lenders reasonably expect a valuable return on loaned funds and would reasonably believe that the Prosper loans are investments.

Finally, with regard to whether an alternate regulatory scheme exists to reduce risk to potential investors, there are currently no appropriate regulatory safeguards for Prosper lenders, such as those against misleading statements by a borrower about the purpose of a loan, the borrower’s employment and income, or even the borrower’s identity, or against misleading statements by Prosper.

Thus, the Prosper notes are securities under *Reves* because: (i) Prosper lenders are motivated by an expected return on their funds; (ii) the Prosper loans are offered to the general public; (iii) a reasonable investor would likely expect that the Prosper loans are investments; and

(iv) there is no alternate regulatory scheme that reduces the risks to investors presented by the platform.

As a result of the conduct described above, Prosper violated Section 5(a) of the Securities Act, which states that unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

Also as a result of the conduct described above, Prosper violated Section 5(c) of the Securities Act, which states that it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Prosper's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Section 8A of the Securities Act, Respondent Prosper cease and desist from committing or causing any violations and any future violations of Sections 5(a) and (c) of the Securities Act.

By the Commission.

Florence E. Harmon
Acting Secretary