No. 14-1195

IN THE
# UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In re Oteria Q. Moses,
*Debtor.*

CASHCALL, INC.,
*Creditor-Appellant*

— v. —

OTERIA Q. MOSES,
*Debtor-Appellee*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NORTH CAROLINA – NO. 13-223

**BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF DEBTOR-APPELLEE AND SEEKING AFFIRMANCE OF THE DISTRICT COURT'S DECISION**

NATIONAL ASSOC. OF CONSUMER BANKRUPTCY ATTORNEYS, *AMICUS CURIAE*
BY ITS ATTORNEY
TARA TWOMEY, ESQ.
NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER
1501 The Alameda
San Jose, CA 95126
(831) 229-0256

On Brief Geoff Walsh
July 3, 2014

# CERTIFICATE OF INTEREST AND CORPORATE DISCLOSURE STATEMENT

*CashCall, Inc. v. Moses* – No. 14-1195

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure *Amicus Curiae* the National Association of Consumer Bankruptcy Attorneys makes the following disclosure:

1) For non-governmental corporate parties please list all parent corporations.
**NONE.**

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock. **NONE.**

3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. **NONE.**

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant.
**NOT APPLICABLE.**

/s/ Tara Twomey
Tara Twomey, Esq.

Dated: July 3, 2014

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## STATEMENT OF INTEREST

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 3,000 consumer bankruptcy attorneys nationwide. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process.

NACBA and its membership have a vital interest in the outcome of this case. CashCall is a predatory lender hiding behind an affiliation with a Native American tribe to evade state licensing and usury laws and issue loans to vulnerable debtors at exorbitant interest rates and unfair terms. Although a dozen states have issued cease and desist orders against CashCall, the company continues to attempt to evade oversight by including arbitration clauses in all of its lending documents. The Bankruptcy Court has a responsibility to police these egregious practices.

## CONSENT

The parties have consented to the filing of this amicus brief.

## CERTIFICATION OF AUTHORSHIP

Pursuant to FRAP 29(c)(5), the undersigned counsel of record certifies that this brief was not authored by a party's counsel, nor did party or party's counsel contribute money intended to fund this brief and no person other than NACBA contributed money to fund this brief.

## SUMMARY OF ARGUMENT

Taking Ms. Moses' adversary proceeding away from the bankruptcy court and sending it to arbitration would significantly undermine implementation of the bankruptcy laws as Congress intended. Ms. Moses raised two claims in her adversary proceeding. Both claims directly implicate one of the essential functions of the bankruptcy court – to adjust claims of debtors and creditors in a single forum consistently with the Bankruptcy Code.

The arbitration at issue here is part and parcel of a larger scheme developed by a notorious internet payday lender that masquerades as an affiliate of a Native American tribe. The tribal association is a ruse to evade state lender licensing and usury laws. At least seventeen states have initiated formal proceedings to stop CashCall's operations affecting their residents. More than ten states, including two in this Circuit, have already issued cease and desist orders against CashCall's internet lending operations. The arbitration provisions that CashCall wrote into its loan documents effectively preclude application of the laws that CashCall wishes to evade. The arbitration is designed to ensure that CashCall can continue its abusive lending practices without oversight.

High-cost small dollar and payday loans often serve as a precarious way station for financially distressed consumers who end up in bankruptcy. Payday lenders like CashCall frequently appear on lists of creditors in chapter 13 cases. Several states have already determined that CashCall's loans are void in whole or in part, and therefore

unenforceable. More states are considering the same action. If CashCall's status can never be challenged directly in bankruptcy courts, CashCall will continue to have a parasitic presence in scores of chapter 13 cases. It will siphon off funds that would otherwise go to pay legitimate creditors. The bankruptcy court has a responsibility to police CashCall's practices. In this instance, arbitration is an escape route that CashCall carefully planned out in advance so that it could evade that much needed policing.

## ARGUMENT

### I. Introduction

In May 2012 Appellee Oteria Moses was living on an income of Social Security and Veterans benefits and she was facing financial hardship. JA:32, 47. She saw a television ad from Western Sky Financial offering small cash loans through a simple online application process. She applied and obtained a loan of $1000. JA:33, 73.

The cost of the loan was extraordinarily high. Ms. Moses incurred a pre-paid finance charge of $500. JA:75. The loan agreement provided for monthly payments of approximately $200 each over the next two years. The scheduled payments would total $4,893.14. JA:79-80. This represented an annual percentage rate of 233.10%. JA:73. In order to obtain the loan Ms. Moses had to agree to electronic fund transfers to the lender directly from the bank account into which her monthly Social Security and VA benefits were deposited. JA:77.

On the face of the loan agreement Western Sky Financial, LLC identified itself as "a lender authorized by the laws of the Cheyenne River Sioux Tribal Nation and the Indian Commerce Clause of the Constitution of the United States of America." The Loan Agreement contained the following statement:

> **This Loan Agreement is subject solely to the exclusive laws and jurisdiction of the Cheyenne River Sioux Tribe, Cheyenne River Indian Reservation.** By executing this Loan Agreement, you, the borrower, hereby acknowledge and consent to be bound to the terms of this Loan Agreement, consent to the sole subject matter and personal jurisdiction of the Cheyenne River Sioux Tribal Court, and that no other state or federal law or regulation shall apply to this Loan Agreement, its enforcement or interpretation.
>
> You further agree that you have executed this Loan Agreement as if you were physically present within the exterior boundaries of the Cheyenne River Indian Reservation, a sovereign Native American Tribal Nation; and that this Loan Agreement is fully performed within the exterior boundaries of the Cheyenne River Indian Reservation, a sovereign Native American Tribal Nation.

JA:76. (emphasis in original).

The Loan Agreement contained an "Agreement to Arbitrate" under which any dispute involving the Agreement must be subject to arbitration, "which shall be conducted by the Cheyenne River Sioux Tribal Nation, by an authorized representative in accordance with its consumer dispute rules and the terms of this Agreement." JA:76.

Three days after loan origination, Western Sky Financial, LLC assigned the loan to a subsidiary of CashCall, Inc. and directed Ms. Moses to make all payments to CashCall in Anaheim, California. JA:80. Ms. Moses filed a petition for chapter 13

relief on August 1, 2012. A week later, CashCall filed a proof of claim in the bankruptcy case, listing itself as the creditor. JA:28. CashCall claimed that it was entitled to payment from the bankruptcy estate of $1,929.02. CashCall's claim was based solely on the $1,000 loan Western Sky had made to Ms. Moses three months earlier. *Id.*

## II. The Absence of a Legitimate Arbitration Alternative to the Bankruptcy Court's Traditional Exercise of its Authority over Creditors' Claims Precludes Arbitration in this Case.

### A. CashCall as a Typical High Cost Small-Dollar Lender

Ms. Moses' loan was typical of many high-cost, small dollar loans made to low and moderate income Americans. Commonly known as "payday" loans, their high fees in relation to the small loan amounts create an astronomically high annual percentage rate, often in the triple digits. *See generally* Nathalie Martin, *1000% Interest – Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563 (Fall 2010). Payday lenders target checking accounts of individuals who have regular income from earnings or government benefits. Online lenders require agreements authorizing electronic fund transfers from the borrower's checking account to the lender. Conditioning credit on such an agreement violates the Electronic Funds Transfer ("EFT") Act, 15 U.S.C. § 1693k. The standard Western Sky/CashCall Loan Agreement contains such a provision (JA 77) and violates the EFT. *CashCall, Inc. v. Morrisey*, -- S.E. 2d --, 2014 WL 2404300, *4 (W. Va. May 30,

2014); *F.T.C. v. PayDay Financial, LLC*, -- F. Supp. 2d --, 2013 WL 5442387, *8 (D.S.D. Sept. 30, 2013).

Typical payday borrowers are low-income consumers who need funds to pay for necessities. Martin, 52 ARIZ. L. REV. at 608. Borrowers seldom understand the loan terms. *Id* at 599-606. A high proportion of payday borrowers default on their repayment obligations. For example, in a survey of 292 West Virginia borrowers with CashCall loans, the state's Attorney General's Office recently found that 212 were in default. *Morrisey*, 2014 WL 2404300 at *1.

The consequences of taking out a payday loan can be severe. Despite terms of the written agreements, lenders like CashCall refuse to honor borrowers' requests to cease electronic funds transfers. *Morrisey,* 2014 WL 2404300 at *12. Payday lenders can be extremely abusive debt collectors. Certain borrowers surveyed by the West Virginia Attorney General had received over 1,000 harassing collection calls from CashCall, sometimes twenty or more per day, including calls to neighbors and employers. *Morrisey,* 2014 WL 2404300 at *4, *11-13.

Not surprisingly, there is a strong correlation between payday lending and recourse to bankruptcy. Nathalie Martin & Koo Im Tong, *Double Down-and-Out: The Connection Between Payday Loans and Bankruptcy*, 30 SW. U. L. REV. 785, 803 (2010) (statewide study finds payday loan usage rates for bankruptcy debtors at four to five times that of the general population); Paige Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt U. Law School, Law & Economics Working Paper

No. 11-13 (2011) (for borrowers with low credit scores access to payday loans causes rate of chapter 13 filings over the next two years to double).[1]

**B. State Regulation of High-Cost and Payday Lenders**

Most states regulate small dollar high-cost loans, including payday loans. A loan with the terms of the one CashCall marketed to Ms. Moses is unlawful under statutes in effect in Maryland, North Carolina, Virginia, and West Virginia. Maryland caps the rate of interest for small loans at 33%[2] and North Carolina at from 15% to 36%.[3] West Virginia regulates payday loans under its Small Loan Act, which sets a 31% interest cap on loans under $2,000.[4] Virginia does not permit payday loans of over $500, sets a 36% simple interest rate cap, and limits the number and sequence of loans to one borrower.[5] South Carolina law prohibits payday loans over $550 that employ post-dated checks, and the state statute sets limits on the number and sequence of payday loans.[6]

Payday lenders have devised various strategies to avoid the reach of state laws such as those in effect in all states within the Fourth Circuit. One strategy has been to

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[1] Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215
[2] Md. Code Ann. Com. Law § 12-306(a)(2) (the 2.75% monthly cap for small loans comes to approximately 33% APR); Md. Code Ann. Com. Law §§ 12-317, 12-306 (a 2% monthly cap applies to loans over $500).
[3] N.C. Gen. Stat. § 53-173(a) (2102 version, providing for 36% for first $600 of loan amount and 36% for any amount over $600 up to $3,000. North Carolina legislation effective in 2013 sets a 30% cap on a $1,000 loan. N.C. Gen. Stat. § 53-176 (S.L. 2013-162, effective July 1, 2013).
[4] W. Va. Code § 46A-4-107(2). *See generally* W.Va. Code §§ 46A-4-107 to 46A-4-113.
[5] Va. Code Ann. §§ 6.2-1816 and 6.2-1817.
[6] S.C. Code Ann. § 34-39-180.

affiliate with a national bank. Federal statutes regulating national banks often preempt state usury laws, or, at a minimum allow a national bank to select a home state with banking laws that leave interest rates substantially unregulated. The West Virginia courts examined CashCall's use of this type of "rent-a-bank" scheme in, *Morrisey*, 2014 WL 2404300 at *6-7. The West Virginia Supreme Court affirmed the lower court ruling that had found CashCall effectively controlled all significant aspects of the loan transactions it originated through a national bank and used the bank solely as a front in order to evade state banking laws.

### C. Payday Lenders and the Tribal Immunity Scheme

Another tactic high-cost lenders have used to evade state laws has been to cloak themselves in tribal immunity. Native American tribes enjoy a broad immunity from suits brought by individuals and states. *Michigan v. Bay Mills Indian Community*, *et al*, --- U.S. --, 134 S. Ct. 2024 (2014) (refusing to reconsider *Kiowa Tribe of Oklahoma v. Manufacturing Technologies, Inc.*, 523 U.S. 751 (1998)). In a variation on the "rent-a-bank" scheme, certain payday lenders have created entities that purport to be affiliated with Native American tribes. The lenders originate high-cost loans through these nominal tribal entities. Shortly after origination, the loans are transferred directly to the payday lender. The tribal entity serves as a front for the lender, supporting a dubious claim of immunity from federal and state laws for all aspects of the lending operation. Nathalie Martin and Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?,* 69 WASH. & LEE L. REV. 751 (2012);

Heather L. Petrovich, *Circumventing State Consumer Protection Laws: Tribal Immunity and Internet Payday Lending*, 91 N.C. L. REV. 326 (2012).

"Rent-a-tribe" arrangements result in little actual income to tribes or to Native Americans. Responsible Native American leaders see the affiliations with payday lenders not as an economic boon to their communities but as a practice that undermines public acceptance of genuine claims for Native American sovereignty. Martin & Schwartz, 69 WASH. & LEE L. REV. at 787. The true loan companies are typically headquartered far from the reservations, and it is the owners of these companies that receive the overwhelming bulk of the income derived from the loans. *See* Petrovich, 91 N.C. L. REV. at 342; Martin & Schwartz, 69 WASH. & LEE L. REV. at 777.

The tribal immunity stratagem has served to shield certain payday lenders from state actions to enforce consumer protection laws. *Cash Advance and Preferred Cash Loans v. State*, 242 P.3d 1099, 1108 (Colo. 2010), *on remand* 2012 WL 3113527 (Colo. Dist. Ct. Feb. 18, 2012); *Ameriloan v. Superior Court*, 86 Cal. Rptr. 3d 572 (Cal. Ct. App. 2008), further decision following remand, 166 Cal. Rptr. 3d 800 (Cal. Ct. App. 2014) (affirming trial court determination that lenders were acting as arm of tribe), *review granted* 324 P.3d 834 (Cal. May 21, 2014). Many states have devoted extensive resources to efforts to control internet lenders that misuse tribal immunity claims. Typically, these proceedings involve years of litigation over enforcement of subpoenas and protracted efforts by the lenders to dismiss proceedings for lack of jurisdiction.

Petrovich, 91 N.C. L. REV. at 339. The proceedings often focus on whether the lender acts legitimately as an "arm of the tribe" or whether the tribal nomenclature is a sham. State investigators have consistently found that CashCall fits into the latter category.

**D. CashCall's Discredited Claim to be a "Tribal" Lender**

The key players in CashCall's tribal immunity scheme are: (1) CashCall, Inc., the true lending entity; (2) WS Funding, LLC, a wholly owned subsidiary of CashCall, Inc.; and (3) Western Sky Financial, LLC., the nominal tribal entity named on the website and in television ads through which CashCall markets its product. Ms. Moses entered into a loan agreement with Western Sky Financial, LLC. JA:73. Three days later, Western Sky Financial, LLC assigned the loan to WS Funding, LLC. JA:80. Ms. Moses ended up with a debt owed to CashCall, Inc. JA:28.

Many courts and state regulatory agencies have examined CashCall's tribal affiliation claim. At least three U.S. districts courts rebuffed CashCall's attempts to remove state proceedings to federal court based on a claim of complete immunity from state enforcement. *Missouri v. Webb*, 2012 WL 1033414 (E.D. Mo. Mar. 27, 2013); *Maryland Commissioner of Financial Regulation v. Western Sky Financial*, LLC, 2011 WL 4894075 (D. Md. Oct. 12 2011) (rejecting a complete immunity claim based on the promissory note purporting to incorporate the Indian Commerce Clause and tribal law); *Colorado v. Western Sky Financial*, LLC, 845 F. Supp. 2d 1178, 1182 (D. Colo. 2011). After the state proceedings resumed Colorado and Maryland found that the tribal sovereignty claims were meritless. Ultimately these two states entered cease and

desist orders against CashCall's lending to state residents, voided past loans to residents, and imposed other sanctions.[7] The Colorado court assessed attorney's fees and costs against CashCall for persisting in its frivolous claim to be a legitimate tribal entity.[8]

The New Hampshire Banking Department also tossed aside CashCall's tribal law shield. *In re CashCall, Inc. et al*, No. 12-308, 2013 WL 3465250 (N.H. Banking Dept. June 4, 2013). The New Hampshire agency found that CashCall controlled and funded Western Financial, LLC's loan origination operations. Under their business model, Western Sky solicited borrowers on a website managed by CashCall. Western Sky assigned loans shortly after origination to WF Funding, LLC, a subsidiary of CashCall. In this arrangement, CashCall was the actual or de facto lender, not Western Sky. *Id* at *2. The Department reviewed the language of Western Sky's promissory note that stated that the contract was subject solely to tribal law. *Id* at *3. According to the Department, "After detailed review of the respondents' business scheme, it appears that Western Sky is nothing more than a front to enable CashCall to evade licensure by state agencies and to exploit Indian Tribal Sovereign Immunity to shield its deceptive business practices from prosecution by state and federal

[7] Colorado *ex rel* Struthers v. Western Sky Financial, LLC, *et al,* No. 11-CV-638 (Denver Co. Dist. Ct. April 15, 2013) (Appx. A-1); Maryland Comm'r of Fin. Regulation v. Western Sky Financial, LLC *et al*, No. CFR-FY2011-182, 2013 WL 318996 (Md. Comm'r Fin. Reg. May 23, 2013) (Final Order and Opinion);
[8] Colorado *ex rel* Struthers v. Western Sky Financial, LLC, *et al,* No. 11-CV-638 (Denver Co. Dist. Ct. April 15, 2013) (Appx. A-1).

regulators." *Id.* The State of New Hampshire entered a cease and desist order against CashCall's lending to state residents, ordered disgorgement of finance charges paid by 787 borrowers, and assessed an administrative fine of $1,967,500 against the affiliated entities. *Id* at *4.

The State of Maryland made similar findings when it entered a cease and desist order against Western Sky. *Maryland Commissioner of Financial Regulation v. Western Sky Financial, LLC et al*, 2013 WL 3188996 (Md. Comm'r Fin. Reg. May 22, 2013). The Maryland regulator found that no evidence supported the claim that an Indian tribe had an ownership interest in or an operating role in Western Sky's lending operation. *Id* at *3. Western Sky was not an arm of any tribe. *Id.* The state agency ordered restitution of payments and imposed a fine of $173,000. *Id.* at *8. The legal bases for Maryland's proceeding were the same as those that Ms. Moses asserted, namely, lending without a state license and charging interest above the state law cap for small loans. *Id.* at *3.

In addition to Missouri, Colorado, Maryland and New Hampshire, five other states have issued cease and decease orders against the CashCall/Western Sky operation. These include: Illinois, Massachusetts, Nevada, Oregon, and Washington.[9]

[9] *In re* Western Sky Fin., LLC, No. 13 CC 265 (Ill. Dept. Fin. & Prof. Reg. Mar. 8, 2013) (Appx. A-2). ; *In re* CashCall, Inc. *et al*, 2013 WL 1737075 (Mass. Consumer Affairs and Bus. Reg. Office April 4, 2013) (disgorgement ordered); *In re* Western Sky Fin., LLC *et al*, 2013 WL 1737086 (Mass. Consumer Affairs and Bus. Reg. Office April 4, 2013) (same); *In re* Western Sky Fin., LLC, 2013 WL 3864655 (Nev. Bus. & Indus. Dept. June 28, 2013) (declaring loans void, ordering restitution); *In re* Western

New York and Connecticut recently entered into consent orders that stopped the CashCall/Western Sky operations in those two states.[10] In several of these rulings the states ordered restitution to borrowers, voided CashCall loans, and imposed significant monetary penalties. Over the past twelve months, seven other states that investigated the CashCall/Western Sky operation brought actions to stop the tribal lending scheme. These actions are pending in California, Florida, North Carolina, Arkansas, Michigan, Georgia, and Minnesota.[11]

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Sky Fin., No. I-12-0039, 2012 WL 6927415 (Or. Cons. & Bus. Servs. Dept. Dec. 13, 2012); *In re* CashCall, Inc., Wash. Dept. of Fin. Inst. No. C.-11-0810-12-SC01 Office Admin. Hrgs. No. 2011-DFI-0041 (Wash. Off. Admin Hrgs. Oct. 18, 2012) http://www.dfi.wa.gov/CS%20Orders/C-11-0810-12-SC01.pdf.

[10] People of New York v. Western Sky Fin., LLC, *et al* No. 451370/2013 N.Y. Supreme Court, New York County Jan. 24, 2014); Summary of settlement at http://www.ag.ny.gov/press-release/ag-schneiderman-announces-settlement-western-sky-financial-and-cashcall-illegal-loans (terms include order to cease collection of finance charges on outstanding loans, refund charges collected (estimated at up to $35 million in debt relief to 18,000 borrowers), and $1.5 million penalty); *In re CashCall, et al,* Conn. Dept. of Banking Findings of Fact, Conclusions of Law & Consent Order April 2, 2014 (restitution to 3,800 borrowers, $400,000 in penalties) text at http://www.ct.gov/dob/cwp/view.asp?a=2246&q=543054.

[11]Cal. Dept. of Business Oversight v. CashCall, Inc., No. 603-8780, June 4, 2014 (copy of complaint at http://www.dbo.ca.gov/ENF/pdf/2014/CFL-CashCall_accusationrev_redacted.pdf); Attorney General of Fla. and Office of Financial Reg. v. Western Sky Fin., LLC, Fla. Cir. Ct. Hillsborough Co. Dec. 23, 2013 (available at http://www.myfloridalegal.com/newsrel.nsf/newsreleases/BAF70B62171752DA85257C4A0076A03F); No. Carolina v. Western Sky Fin., LLC, No. 13CV16487, Wake Co. Superior Ct. Dec. 16, 2013 (available at http://ncdoj.gov/getdoc/0c087145-6dc7-4911-958a-705a8d75ddf4/CashCall-Complaint-Final-12-16-2013.aspx); Arkansas v. Western Sky Fin., LLC, No. 60CV-13-3-893, Pulaski Co. Cir. Ct. Oct. 1, 2013 (Appx. A-3); Mich. Dept. of Ins. & Fin. Srvs. v. Western Sky Financial, LLC, Aug. 1, 2013 (summary at http://www.michigan.gov/difs/0,5269,7-303--309801--,00.html); Georgia v. Western Sky Fin., LLC, No. 2013-cv-234310, Fulton Co. Super. Ct. July 26, 2013 (available at

### E. "Tribal Arbitration" is an Extension of CashCall's Deceptive Tribal Immunity Scheme

Two federal courts recently gave in to demands of CashCall and its related entities and referred litigation to tribal arbitration. *Inetianbor v. CashCall, Inc.*, 923 F. Supp. 2d 1358 (S.D. Fla. 2013); *Jackson v. Payday Financial, LLC, et al,* 2012 WL 2722024 (N.D. Ill. July 9, 2013). After initially directing the consumer's complaint to arbitration, the Florida district court in *Inetianbor* reconsidered its order. After reconsideration and two failed attempts at arbitration, the court found that there were no rules to apply under CashCall's purported arbitration system. *Inetianbor v. CashCall, Inc.*, 962 F. Supp. 2d 1303, 1309 (S.D. Fla. Aug. 19, 2013). Ultimately the Florida court vacated its referral to arbitration, concluding that the evidence demonstrated that "1) the arbitral forum does not exist, and 2) rules governing the purported forum do not exist." *Id.*

In *Jackson,* Illinois borrowers brought a class action challenging the lending practices of Western Sky, CashCall and several related internet based high-cost lenders. The district court initially ordered tribal arbitration. *Jackson*, 2012 WL 2722024, at *3-4. The plaintiffs appealed this decision. *Jackson v. Payday Financial, LLC, et al*, No. 12-2617 (7th Cir.). After the Seventh Circuit certified a question back to the

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http://law.ga.gov/sites/law.ga.gov/files/related_files/site_page/Amended%20Complaint.pdf); Minnesota v. CashCall, et al No. 27-cv-13-12740, Hennepin Co. Dist. Ct. July 11, 2013 (available at https://www.ag.state.mn.us/PDF/ Consumer /Internet LenderScheme.pdf).

Illinois district court as to whether any valid arbitration system existed under the CashCall/Western Sky operation, the district court vacated the referral. The district court concluded that some evidence supported a finding that, albeit with varying degrees of difficulty, parties might be able to track down some identifiable tribal laws. *Jackson v. Payday Financial, LLC,* No. 11 C 9288 (N.D. Ill. August 28, 2013) (District Court's Response to Court of Appeals Remand for Findings of Fact, Doc. No. 95) (Appx. A-4). However, the district court found the evidence "abundantly clear" that there was no viable arbitration option. The court determined that CashCall used the tribal law verbiage in its contracts as part of a scheme to evade federal and state laws. Findings at p.6. The court concluded, "the intrusion of the Cheyenne River Sioux Tribal nation into the contractual arbitration provision appears to be merely an attempt to escape otherwise applicable limits on interest charges." *Id.* According to the court, "the promise of a meaningful and fairly conducted arbitration is a sham and an illusion." *Id.*

## III. The Bankruptcy Court Appropriately Exercised Discretion to Maintain Control over the Adversary Proceeding Against CashCall

### A. Bankruptcy Law's Impact on Arbitration Clauses

The U.S. Bankruptcy Code impacts the dispute between Ms. Moses and CashCall in two significant ways. First, in bankruptcy CashCall cannot rely on the tribal sovereignty claims that form the cornerstone of its efforts to avoid the reach of federal and state laws. Congress has the power to abrogate tribal immunity, and most

courts have held that it did so through enactment of the Bankruptcy Code. 11 U.S.C. § 106(a); *Krystal Energy Co. v. Navajo Nation*, 357 F.3d 1055, (9th Cir. 2004). Aside from the abrogation under § 106(a), a tribal entity (even a legitimate one) waives sovereign immunity when it files a proof of claim in a bankruptcy case. *Confederated Tribes of the Colville Reservation Tribal Credit v. White*, 139 F. 3d 1268 (9th Cir. 1998).[12] Second, the need to ensure effective functioning of the bankruptcy system is a basis for displacing the deference to arbitration set forth in the Federal Arbitration Act ("FAA"). 9 U.S.C. § 2.

The relevant test for assessing whether a bankruptarkincy court may refuse to enforce a pre-bankruptcy arbitration clause in a contract is set out in *Shearson/Am. Express v. McMahon*, 482 U.S. 220, 227 (1987). Under this test, a bankruptcy court may exercise its discretion to refuse to compel arbitration in a particular case when it finds an "inherent conflict" between arbitration and the purposes of the Bankruptcy Code. *In re Thorpe Insulation Co.*, 671 F.3d 1011, 1021-22 (9th Cir. 2012); *In re White Mountain Mining Co*, 403 F.3d 164, 169-70 (4th Cir. 2005). The courts have looked to a common set of concerns in evaluating whether arbitration conflicts with the Code's underlying purposes. These include protection of reorganizing debtors from piecemeal litigation,

[12] A North Dakota district court recently refused to compel arbitration and deferred ruling on the enforceability of various versions of the CashCall arbitration language. *Heldt v. Payday Fin., LLC*, -- F. Supp. 2d --, 2014 WL 1330924 (D.S.D. Mar. 31, 2014). Before it ruled on the validity of the arbitration clause, the court wanted to give a tribal court the opportunity to rule on its own jurisdiction. *Id.* at *18-21. In the bankruptcy context, this jurisdictional deference would not be an issue.

the centralization of disputes over the debtor's legal obligations, and the efficiency of bankruptcy proceedings. *White Mountain,* 403 F.3d at 170; *see also Thorpe Insulation*, 671 F.3d at 1022; *In re Gandy*, 299 F.3d 489, 500 (5th Cir. 2002).

### B. Both Claims in Ms. Moses' Adversary Proceeding Require that the Bankruptcy Court Make Essential Bankruptcy Determinations

CashCall filed a proof of claim in Ms. Moses' bankruptcy case. The first count of Ms. Moses' adversary proceeding asks the bankruptcy court to determine whether CashCall has a valid claim. Determination of the validity of a proof of claim fits squarely within the bankruptcy court's essential functions. In considering whether a dispute over the validity of a creditor's proof of claim met the *McMahon* "inherent conflict" standard, this Court ruled:

> We thus turn to whether there is an inherent conflict between arbitration and the underlying purposes of the bankruptcy laws. "[T]he very purpose of bankruptcy is to modify the rights of debtors and creditors," 1 *Collier on Bankruptcy,*¶ 3.02[2] (15th ed. rev. 2005) (quotation omitted), and Congress intended to centralize disputes about a debtor's assets and legal obligations in the bankruptcy courts, *see Grady v. A.H. Robins Co.,* 839 F.2d 198, 201-02 (4th Cir.1988); 28 U.S.C. § 157. Arbitration is inconsistent with centralized decision-making because permitting an arbitrator to decide a core issue would make debtor-creditor rights "contingent upon an arbitrator's ruling" rather than the ruling of the bankruptcy judge assigned to hear the debtor's case.

*White Mountain*, 403 F.3d at 169-70.

Other circuits have similarly concluded that the bankruptcy system could not work if bankruptcy courts routinely sent proof of claim disputes to arbitration. *In re*

*National Gypsum Co.*, 118 F.3d 1056, 1067 n.18 (5th Cir. 1997) (enforcement of arbitration in proof of claim disputes would mean "effectively contracting out of a bankruptcy court's power to adjust claims among different classes of creditors"); *Gandy*, 299 F.3d at 499 (affirming denial of motion to compel arbitration; filing a proof of claim invokes the "peculiar powers of the bankruptcy court" and a claim dispute "is a core proceeding because it could arise only in the context of bankruptcy."); *In re United States Lines,* 197 F.3d 631, 637 (2d Cir. 1999), *cert. denied* 529 U.S. 1038 (claim allowance proceeding is one that is "unique to or uniquely affected by the bankruptcy proceedings"); *Thorpe Insulation,* 671 F.3d at 1023 ("Arbitration of a creditor's claim against a debtor, even if conducted expeditiously, prevents the coordinated resolution of debtor-creditor rights and can delay the confirmation of a plan of reorganization."); *In re Electric Machinery Enterprises, Inc.*, 479 F.3d 791, 798 (11th Cir. 2007) (arbitration appropriate because the dispute at issue "does not involve the traditional purpose of the bankruptcy court - modifying the rights of creditors who make claims against the bankruptcy debtor's estate.").

In the second claim of her adversary proceeding Ms. Moses seeks damages resulting from CashCall's attempts to collect an invalid debt, relying upon N.C. Gen. Stat. §75-51 to §75-54 and N.C. Gen. Stat. § 75-1.1. JA 38-30. Ms. Moses' second claim is premised on the soundness of her first claim. If CashCall had a valid debt, it did not violate any state laws by asking Ms. Moses to pay it. It would be a different story if Ms. Moses had alleged that CashCall called her one thousand times, twenty

times a day, and told her neighbors about her debt (as CashCall did to certain West Virginia debtors, *supra* at p.14 ). That claim would not be solely dependent on the invalidity of the underlying debt. A debt collector enforcing a perfectly valid debt could not lawfully engage in such outrageous behavior. In her second claim, Ms. Moses seeks to recover damages on a claim that is premised *only* on the underlying invalidity of the debt. The second claim has as its foundation the identical legal issue raised in the first claim.

In the instant case the same legal issue is central to resolution of the dispute over allowance of a proof of claim and the counterclaim against the creditor who filed the claim. The Court in *Stern* distinguished Vickie Marshall's counterclaim from the counterclaims involved in two other rulings, *Langenkamp v. Culp*, 498 U.S. 42 (1990) (*per curiam*) and *Katchen v. Landy*, 382 U.S. 323 (1966). *Stern v. Marshall*, 131 S. Ct. 2594, 2616-17 (2011). In both *Katchen* and *Langenkamp* the bankruptcy courts *could* decide all issues involving the validity of proofs of claim and counterclaims against the creditors who filed the claims. This was because in *Katchen* and *Langenkamp* the counterclaims required that the bankruptcy court decide the same issue addressed in the proof of claim disputes. By contrast, in Vickie Marshall's case there was merely "some overlap" between her proof of claim dispute and her counterclaim against the creditor. In *Katchen* and *Langenkamp* resolution of the validity of the proofs of claim would "necessarily resolve" the counterclaims. *See Stern*, 131 S. Ct. at 2617. The same is true for the proof of claim and counterclaim in Ms. Moses' case.

The two counts of Ms. Moses' adversary proceeding must be resolved together. In other cases parties have tried to separate different aspects of a proof of claim dispute and sought to send certain issues to arbitration while leaving others to be resolved by the bankruptcy court. The courts have rejected this option as inefficient and likely to create conflicting decisions that undermine the bankruptcy courts' role as a unified dispute resolution system for claims. *Thorpe Insulation,* 671 F. 3d at 1024 n.11; *Gandy*, 299 F.3d at 499.

CashCall's argument for arbitration mischaracterizes the jurisprudence around "core" and "non-core" proceedings in bankruptcy, then applies those misconceptions in the most rigid manner possible.[13] It is true that when discussing whether refraining from arbitration is appropriate in the bankruptcy context courts often discuss the core/non-core distinction.[14] However, the courts resist the mechanical use of these terms. *National Gypsum,* 118 F.3d at 1067 n.18 (the core/non-core distinction is "too broad" and "conflates the inquiry set forth in *McMahon* and *Rodriguez* with the mere identification of the jurisdictional basis of a particular bankruptcy proceeding."); *In re Mintze*, 434 F.3d 222, 229 (3d Cir. 2006) (core/non-core distinction not determinative for arbitration); *Thorpe Insulation Co.*, 671 F.3d at 1021 ("the core/non-core distinction,

[13] For example, CashCall asserts that that there is a rule to the effect that every non-core matter *must* be referred to arbitration. CashCall Brief p.24 ("If a cause of action is non-core, it must be referred to arbitration."). This is a mischaracterization of the authority CashCall cites, *In re Crysen/Montenay*, 226 F.3d 160, 166 (2d Cir. 2000). In *Crysen* the court stated that "generally" non-core matters are referred to arbitration. *Id.*
[14] *See* Appellee's Brief pp.7-8, discussing core/non-core distinction.

though relevant, is not alone dispositive"). The definition of a core proceeding itself is not rigid. Core proceedings "include, but are not limited to" the sixteen listed in the statute. 28 U.S.C. § 157(b)(2). The definition expressly includes "other proceedings affecting … the adjustment of the debtor-creditor ... relationship. 28 U.S.C. § 157(b)(2)(O).

Both claims in Ms. Moses' adversary proceeding fall within the scope of what Congress deemed to be core proceedings. 28 U.S.C. § 157(b)(2)(B) (allowance or disallowance of claims); 28 U.S.C. § 157(b)(2)(C) (counterclaims by the estate against persons filing claims against the estate). To the extent that the core/non-core nomenclature is important for evaluation of the propriety of arbitration, the inclusion of both claims in the list of core proceedings is significant.

Congress developed the core/non-core distinction in response to the Supreme Court's holding that there were constitutional limits on the bankruptcy courts' authority to enter final judgments in certain proceedings. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.,* 458 U.S. 50 (1982). Following *Marathon,* Congress enacted § 157(b)(2) with its list of core proceedings in order to define the types of proceedings that "fell within the scope of the historical bankruptcy court's power." *Executive Benefits Insurance Agency v. Arkison*, -- S. Ct. --, 2014 WL 2560461 * 6 n.7 (U.S. June 9, 2014). The list of sixteen core proceedings in 28 U.S.C. § 157(b)(2) represents Congress's view of what are the essential types of proceedings that go to the heart of the bankruptcy courts' adjudicatory role. Congress's assessment of the limits of the

bankruptcy courts' constitutional authority to enter final judgments in all listed core proceedings turned out to be wrong. *Stern v. Marshall*, 131 S. Ct. 2594 (2011). The *Stern* court ruled that bankruptcy courts may hear all aspects of core proceedings but not enter final orders in certain core proceedings. This ruling does not affect Congress's expressed intent regarding the historical importance of the designated core proceedings in the overall functioning of the bankruptcy system. For purposes of the *McMahon* "inherent conflict" determination, the fact that both of Ms. Moses' claims involve what Congress declared to be core bankruptcy proceedings is a significant factor to consider.

### C. It is Essential for the Integrity of the Bankruptcy System that the Bankruptcy Court Hear Ms. Moses' Claims.

CashCall's handling of its proof of claim in this case highlights why the bankruptcy court acted appropriately in maintaining close control over this debtor-creditor relationship. CashCall has filed over one hundred proofs of claim in chapter 13 cases in this one bankruptcy district. JA:66-69. In filing its proofs of claim, CashCall games the system. CashCall's business model relies on a claim of tribal immunity to evade regulation. However, the filing of a proof of claim in a bankruptcy case waives any immunity it might have. *See* p. 24, *supra.* CashCall tries to have it both ways. If no one objects to its claim, CashCall participates in the Chapter 13 process and takes all the funds it can get from the bankruptcy estates. If the trustee or a

debtor objects to CashCall's proof of claim, CashCall tries to withdraw the claim and disappear. This cat-and-mouse game is a manipulation of the bankruptcy system. A bankruptcy court has authority to use its equitable powers to control such conduct.

The bankruptcy court has specific authority under the Federal Rules of Bankruptcy Procedure to apply equitable principles to regulate the withdrawal of a proof of claim. Fed .R. Bankr. P. 3006. Rule 3006 generally allows a creditor to withdraw a proof of claim. However, the creditor may not do so without court approval once an objection or adversary proceeding has been filed challenging the claim. Rule 3006 builds upon the authority bankruptcy courts have always had to prevent the calculated withdrawal of a contested proof of claim. *In re Kelso Bros. Roofing Co.,* 122 F.2d 867 (8th Cir. 1941); *In re Chateaugay Corp.,* 165 B.R. 130, 133 (S.D.N.Y. 1994). The Rule has been applied to block a creditor's attempt to resurrect immunity protections that it lost upon the filing of a proof of claim. *In re Barrett Refining Corp*., 221 B.R. 795, 814 (Bankr. W.D. Okla. 1998) (state that waived sovereign immunity by filing proof of claim could not undo the waiver by withdrawing its proof of claim); *In re Hills*, 35 F. Supp. 532 (W.D. Wash. 1940) (decided under Bankruptcy Act, upholding bankruptcy referee's refusal to allow creditor to withdraw proof of claim after trustee brought state law usury claim against creditor). *See also In re EDS, Inc*., 301 B.R. 436 (Bankr. D. Del. 2003) (creditor that waived right to jury trial by filing proof of claim could not regain the right by withdrawing the proof of claim).

If one creditor engages in a practice that affects many consumer debtors who lack the financial resources to litigate over relatively small sums, harmful practices will escape the bankruptcy court's control. Systemic abuses must be addressed in a specific case. For example, a Louisiana bankruptcy court observed that one mortgage servicer repeatedly filed proofs of claim in consumer bankruptcy cases that included charges for excessive and inappropriate fees. *In re Jones*, 2012 WL 1155715 (Bankr. E.D. La. April 5, 2012). In ruling on the facts presented by one homeowner's case, the court imposed sanctions of over $3 million dollars against the mortgage servicer. Such awards serve as a deterrent to future misconduct and rid the bankruptcy system of abusive practices affecting many parties. In other instances bankruptcy courts have imposed sanctions intended to be meaningful against creditors that engaged in conduct that, if left unchecked, would interfere with proper functioning of the bankruptcy system.[15] In Ms. Moses' case the bankruptcy court similarly has the opportunity and the responsibility to address a systemic abuse.

**D. This Bankruptcy Case is Not Over.**

Under her chapter 13 plan Ms. Moses committed to pay $1250 monthly for five years (a total of $75,000) from her exempt Social Security and Veterans Administration benefits toward satisfaction of debts owed to her creditors. JA:43-47. The plan proposes a 100% payment of debts owed to priority and secured creditors.

[15] *See, e.g., In re Diviney*, 225 B.R. 762 (B.A.P. 10th Cir. 1998); *In re Iskric*, 496 B.R. 355 (Bankr. M.D. Pa. 2013); *In re Dynamic Tours & Transp.*, Inc., 359 B.R. 336 (Bankr. M.D. Fla. 2006).

*Id.* In a "water under the bridge" argument, CashCall asserts that Ms. Moses' plan has been confirmed, that the plan did not allocate funds for unsecured creditors, and therefore her adversary proceeding could not possibly have any impact on the bankruptcy estate. CashCall Brief pp. 49-50. Unlike *MNBA America Bank, N.A. v. Hill*, 436 F.3d 104 (2d Cir. 2006), the decision that CashCall relies upon, this appeal involves a chapter 13 case and not a chapter 7 case. This makes a difference.

As a chapter 13 debtor, Ms. Moses pursues the claims against CashCall on behalf of the chapter 13 estate, as the estate's representative. *Wilson v. Dollar General Corp.*, 717 F.3d 337, 343 (4th Cir. 2013). Even after plan confirmation, the chapter 13 debtor's receipt of a significant and unexpected financial benefit can trigger an obligation to increase plan payments. 11 U.S.C. § 1329; *Pliler v. Stearns*, 747 F.3d 260, 265 (4th Cir. 2014) ("A five-year plan duration thus still makes sense, and may still result in gains for creditors even if the debtors have zero or negative disposable income at the time of plan confirmation."). This Court has recognized the impact of section 1329 on confirmed chapter 13 plans numerous times. *Carroll v. Logan*, 735 F.3d 147 (4th Cir. 2013); *In re Murphy*, 474 F.3d 143 (4th Cir. 2007); *In re Arnold*, 869 F.2d 240 (4th Cir. 1989).

Ms. Moses' proposed amended complaint (A.P. Docket Item No. 65) directly addresses CashCall's use of a tribal affiliation claim as a deceptive trade practice. As noted above, state courts and agencies have imposed significant monetary sanctions against CashCall based on findings that Cashcall engaged in the same practices that

are the subject of Ms. Moses' adversary proceeding. As a deterrent to future misconduct and as compensation for past harm, these tribunals have imposed monetary sanctions running into hundreds of thousands and even millions of dollars against CashCall. Because she is pursuing her lawsuit as the representative of the chapter 13 estate, Ms. Moses remains accountable to the bankruptcy court and trustee for any significant non-exempt monetary award she receives. These funds would be available to pay legitimate creditors and could significantly affect the bankruptcy estate.

## CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

Respectfully Submitted,

/s/ Tara Twomey
NATIONAL ASSOC. OF CONSUMER BANKRUPTCY ATTORNEYS, *AMICUS CURIAE*
BY ITS ATTORNEY
TARA TWOMEY, ESQ.
NATIONAL CONSUMER BANKRUPTCY RIGHTS CENTER
1501 The Alameda
San Jose, CA 95126
(831) 229-0256

## CERTIFICATION OF COMPLIANCE WITH TYPE-VOLUME LIMITATION

I hereby certify that the foregoing Brief contains 6,773 words, excluding the parts of the Brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). In preparing this certification, I relied on the word-processing system used to prepare the foregoing Brief.

The foregoing Brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it was prepared in a proportionally spaced typeface using Microsoft Word in 14-point Garamond font.

Dated: July 3, 2014.

/s/ Tara Twomey
Tara Twomey

## CERTIFICATE OF SERVICE

Tara Twomey, attorney for amicus curiae, certifies that on this 3rd day of July, 2014, she caused the foregoing Brief to be electronically filed. Copies of same have been served upon the following this same date by the CM/ECF system:

Counsel for Debtor:
Adrian M. Lapas
STRICKLAND, LAPAS, AGNER & ASSOCIATES
112 N. Williams Street
Goldsboro, NC 27530

Matthew W. H. Wessler
Leah M. Nicholls
PUBLIC JUSTICE, P.C.
1825 K Street, NW, Suite 200
Washington, DC 20006

Counsel for CashCall:
Raymond M. Bennett
Email: rbennett@wcsr.com
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC
2100 First Union Capitol Center
150 Fayetteville Street
Raleigh, NC 27601-0000

Jesse Andrew Schaefer
Email: jschaefer@wcsr.com
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC
2100 First Union Capitol Center
150 Fayetteville Street
Raleigh, NC 27601-0000

Hayden J. Silver, III
Email: jsilver@wcsr.com
WOMBLE CARLYLE SANDRIDGE & RICE, PLLC
2100 First Union Capitol Center
150 Fayetteville Street
Raleigh, NC 27601-0000

## APPENDIX A

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|---|---|
| DISTRICT COURT, DENVER COUNTY, STATE OF COLORADO<br>City and County Building<br>1437 Bannock, Denver, CO 80202 | DATE FILED: April 15, 2013<br><br>▲ **COURT USE ONLY** ▲ |
| **Plaintiffs:** STATE OF COLORADO ex rel. JOHN W. SUTHERS, ATTORNEY GENERAL FOR THE STATE OF COLORADO, AND LAURA UDIS, ADMINISTER UNIFORM CONSUMER CREDIT CODE<br>v.<br>**Defendants:** WESTERN SKY FINANCIAL, LLC, AND MARTIN A. WEBB | Case Number: 11 CV 638<br>Courtroom: 259 |
| **ORDER** | |

**THIS MATTER** is before the Court on Plaintiffs the State of Colorado ex rel. John W. Suthers, Attorney General for the State of Colorado, and Laura Udis, Administer, Uniform Consumer Credit Code's (the "State") Motion for Partial Summary Judgment – Second Claim for Relief, filed December 27, 2012. Defendants Western Sky Financial, LLC ("Western Sky"), and Martin A. Webb ("Webb") (collectively "Defendants") filed their Response on January 31, 2013. The State filed its Reply on March 8, 2013. The Court has reviewed the Motion, the pleadings in support and opposition, the case file, and the relevant authority, and, being fully informed, finds and orders as follows:

**BACKGROUND**

This dispute arises over allegedly illegal, usurious, and unlicensed loans, issued over the Internet, in Colorado to Colorado consumers. The State alleges that Western Sky, a South Dakota limited liability company, has conducted business, through the Internet, to make loans to Colorado consumers in amounts ranging from $400 to $2,600 with annual percentage interest

rates ("APR") of approximately 140% to 300%. Webb is the sole manager and owner of Western Sky. Further, Webb is an enrolled member of the Cheyenne River Sioux (the "Tribe") and resides on the Cheyenne River Indian Reservation (the "Reservation") in South Dakota.

In 2010, Western Sky made more than 200 such loans to Colorado consumers. Following an investigation, the State determined that Western Sky was making "unlicensed supervised loans" and imposing excessive finance charges. After Western Sky failed to comply with a demand that it cease and desist from making further loans, the State filed suit against Defendants seeking injunctive relief and damages.

**UNDISPUTED FACTS**

1. Western Sky is a South Dakota company. Webb is Western Sky's sole manager, sole executive officer, and sole owner. Webb directs, controls, manages, participates in, supervises, is responsible for, and authorizes Western Sky's activities.

2. Western Sky is principally engaged in the business of making small, short-term personal loans to consumers.

3. Via the Internet and television advertising, Western sky offers and enters into loans with Colorado consumers.

4. According to its website, Western Sky offers personal loans of up to $2,600.00.

5. Also according to its website and a loan agreement with a Colorado consumer the loans have APRs from 140% to over 300%. The loan agreement with the Colorado consumer reflects a loan for $400.00 with over 330% APR. *See* Exhibits 1 and 2 to the affidavit of Jodie Robertson. (Robertson Aff., attached to the State's Motion as Exhibit 2).

6. Colorado Consumers apply for loans directly through Western Sky's Website.

7. Western Sky electronically deposits the loans' proceeds into the consumers' bank accounts.

8. Pursuant to the loan agreements, consumers authorize Western Sky to withdraw funds electronically from the consumers' bank accounts.

9. In 2010 alone, Western Sky made over 200 loans to Colorado consumers.

10. Western Sky is not, and at no relevant time was, licensed as a supervised lender in Colorado authorized to make supervised loans pursuant to Colorado's Uniform Consumer Credit Code, C.R.S. § 5-1-101, *et seq*. (the "Code").

11. In November 2010, Administrator Udis (the "Administrator") demanded that Western Sky cease making any new loans. The Administrator also demanded that Western Sky make refunds to consumers of all of its loans' improper and excess finance charges.

12. Western Sky did not comply with the Administrator's demands.

**STANDARD OF REVIEW**

Summary judgment is appropriate when, based on the pleadings, no genuine issue as to any material fact exists and the moving party is entitled to judgment as a matter of law. C.R.C.P. 56(c); *Cotter Corp. v. American Empire Surplus Lines Ins. Co.*, 90 P.3d 814, 819 (Colo. 2004). The purpose of summary judgment is to permit the parties to pierce the formal allegations of the pleadings and save the time and expense associated with trial when, as a matter of law, one party could not prevail. *Peterson v. Halsted*, 829 P.2d 373, 375 (Colo. 1992). The nonmoving party must receive the benefit of all favorable inferences that may be reasonably drawn from the undisputed facts, and all doubts are resolved against the moving party. *Clementi v. Nationwide Mut. Fire Ins. Co.*, 16 P.3d 223, 225-26 (Colo. 2000).

A party may move for summary judgment on an issue it would not bear the burden of proof upon at trial. *Casey v. Christie Lodge Owners Ass'n, Inc.*, 923 P.2d 365, 366 (Colo. App. 1996). In such an instance, the burden is on the moving party to establish the "nonexistence of a genuine issue of material fact." *Civil Serv. Comm'n v. Pinder*, 812 P.2d 645,649 (Colo. 1991) (*citing Continental Airlines, Inc. v. Keenan*, 731 P.2d 708, 712 (Colo. 1987)). This burden may be satisfied by "demonstrating that there is an absence of evidence in the record to support the

nonmoving party's case." *Id*. "An affirmative showing of specific facts, un-contradicted by any counter affidavits, leaves a trial court with no alternative but to conclude that no genuine issue of material fact exists." *Civil Serv. Comm'n*, 812 P.2d at 649 (*citing Terrell v. Walter E. Heller & Co.*, 439 P.2d 989, 991 (Colo. 1968)).

**ANALYSIS**

The State requests that this Court enter summary judgment regarding Defendants' liability on its second claim for relief, "Refunds to Consumers – Code Unlicensed Lender." Specifically, the State contends that Defendants made and collected supervised loans without a supervised lender's license, in violation of § 5-2-301 the Code, and therefore, Defendants are subject to penalty under the Code.

The Code prohibits a person from making or collecting supervised loans without a supervised lender's license, providing that:

> (1) Unless a person . . . has first obtained a license from the administrator authorizing him or her to make supervised loans, he or she shall not engage in the business of:
>
> (a) Making supervised loans or undertaking direct collection of payments from or enforcement of rights against consumers arising from supervised loans he or she has previously made.

Code § 5-2-301(1)(a). Where a creditor has violated the Code regarding the authority to make supervised loans contained in Code § 5-2-301:

> the consumer is not obligated to pay the finance charge and has a right to recover from the person violating this code . . . a penalty in an amount to be determined by the court not in excess of three times the amount of the finance charge . . . .

Code § 5-5-201(1). Further, Code § 5-6-114 authorizes the State to seek these amounts on the consumers' behalves and provides that the Administrator may "bring an action against a creditor

for making or collecting charges in excess of those permitted by this code" and, if "an excess charge has been made, the court shall order the respondent to refund to the consumer the amount of the excess charge and to pay a penalty to the consumer as provided in [§] 5-5-201."

Code § 5-1-301(47) defines a "supervised" loan as a consumer loan with an APR in excess of 12%. In turn, a consumer loan is a loan in which: (1) the consumer is a person other than an organization; (2) the principal does not exceed $75,000; (3) a loan finance charge is made; and (4) the debt is incurred primarily for personal, family, or household purposes. *See* Code § 5-1-301(15)(a).

Here, the undisputable facts before the Court confirm that Western Sky makes and collects unlicensed supervised loans to Colorado citizens, thereby subjecting Defendants to liability under the Code.[1] However, Defendants assert that the State's Motion fails because: (1) Mr. Webb is a Native American who conducts business within the boundaries of the Reservation, and therefore, Webb and his company, Western Sky, are subject to tribal immunity and federal preemption, not subject to state jurisdiction and control; and, (2) in its Motion, the State improperly "relies heavily on the non-binding stipulation [of fact] in an unrelated federal court case [*FTC v. Payday Financial, LLC*, Case No. 11 CV 03017 (D.S.D. May 18, 2012) (the "South Dakota Case")]."

**I. Defendants' contention that the State's Motion fails because it improperly relies on the Non-Binding Stipulation in the South Dakota Case is not persuasive.**

Defendants assert that the State improperly relied on the stipulation from the South Dakota Case. Specifically, Defendants maintain that the State's contentions, based on the

[1] While Defendants deny certain of Plaintiff's allegation with respect to Defendants making and collecting supervised loans without a license, their denials are simply not supported by the record before the Court.

stipulation, that Western Sky: (a) "makes withdrawals from the consumer's bank account'" (b) "initiates collection procedures if the consumer foes not pay the loan;" and, (c) "collected illegal and unlicensed supervised loans," are clearly disputed and contradicted by the record before the Court. Therefore, Defendants assert that summary judgment is not appropriate.

However, in its Motion, the State contends that the facts are "taken principally from the Complaint's allegations that [D]efendants admit in their Answer." While the aforementioned facts, as alleged by the State derive from the stipulation in the South Dakota Case, other salient facts come from Defendants' own documents, their discovery responses, sworn affidavits, and deposition testimony. Further, as discussed in greater detail below, the disputed facts referenced above with respect to Defendants' withdrawal and collection procedures are not material to resolving the present issue before the Court – whether Defendants are liable under the Code – as there is ample undisputed evidence before the Court to establish that Defendants have engaged in unlicensed supervised loans and are not entitled to tribal immunity or federal preemption with respect to their business activities.

**II. Defendants are not entitled to Tribal Immunity or Federal Preemption.**

Turning next to Defendants' contention that they are entitled to tribal immunity because they are conducting business on the Reservation, the Court concludes that Defendants' argument is without merit. This Court addressed this very argument in its Order dated, April 17, 2012, denying Defendants' Motion to Dismiss, rejecting Defendants' assertion that the State is attempting to reach into and regulate on-reservation activity. Defendants' recycling of this same argument here is equally unpersuasive.

Specifically, in the April 17, 2012 Order, this Court found *State ex rel. Suthers v. Cash Advance & Preferred Cash Loans*, 205 P.3d 389 (Colo. App. 2008) ("*Cash Advance I*") instructive on this issue, where, in a near identical factual scenario to this action, the State attempted to investigate a tribal entities alleged usurious internet loan making to Colorado consumers in violation of Colorado's Consumer Credit Code and Consumer Protection Act. *Id.* at 394, *aff'd sub nom. Cash Advance & Preferred Cash Loans v. State*, 242 P.3d 1099 (Colo. 2010).

In *Cash Advance I*, the Court of Appeals determined that business conducted via the internet, which is identical to the type of business conducted by Western Sky here, was sufficient to confer jurisdiction to the State and demonstrated that the business activity constituted off-reservation activity. *See Cash Advance I*, 205 P.3d at 400. Observing that violations of Colorado's Consumer Credit Code and Consumer Protection Act would have significant off-reservation effects that would require the State's intervention, the Court of Appeals held that the State had jurisdiction to "investigate, criminally prosecute, seek declaratory and injunctive relief, and pursue civil remedies for conduct occurring within its borders." *See id.* at 403.

Nevertheless, Defendants maintain that the application of the five-factor test, set forth in *Cash Advance I*, as applied to their business activities here, establish that Western Sky's lending activities occur within the boundaries of the Reservation, thereby preventing the State's enforcement efforts in accordance with tribal immunity. The Court does not agree.

In *Cash Advance I*, the Court of Appeals provided the following factors for courts to consider when determining whether lending activity took place off-reservation: (1) where the contract was entered into; (2) where the contract was negotiated; (3) where performance will

occur; (4) where the subject matter of the contract is located; and, (5) where the parties reside. 205 P.3d at 400. However, in *Cash Advance I* the Court of Appeals did not rely on those factors. Rather, as set forth above, the Court of Appeals employed a long-arm analysis, to conclude that "[b]usiness conducted over the Internet that would confer jurisdiction on a state court also demonstrates that the business activity constitutes off-reservation activity." *Id*. Further, an application of the *Cash Advance I* factors to the uncontroverted facts presented here leads this Court to no contrary conclusion that Defendants' lending activities occur off-reservation.

Similarly, Defendants' contention that Webb is individually protected by tribal immunity as a member of the Tribe is in vain. Again, the Court addressed this very contention in its April 17, 2012 Order, denying Defendants' Motion to Dismiss. Webb, as an enrolled member of the Tribe, is not individually entitled to immunity, nor does his membership in the Tribe confer such immunity upon Western Sky. *See Puyallup Tribe, Inc. v. Dep't of Game*, 433 U.S. 165, 171,72 (1977) (holding that the "doctrine of sovereign immunity . . . does not immunize individual members of [a] tribe.").

Defendants also contend that the State has no regulatory authority of Webb because Webb conducts business through a legally recognized business entity, and the State has alleged no facts sufficient to pierce the corporate veil with respect to Webb. Conversely, the State maintains that Webb's individual liability is not dependent on any "piercing the corporate veil" or "alter ego" theory. Rather, the State contends that Webb's liability flows from the long and well-established principle that those responsible for corporate wrongdoing are personally liable for the corporation's wrongful acts.

In support of its contention, the State directs the Court to several cases from other persuasive jurisdictions. First, in *F.T.C. v. Amy Travel Serv., Inc.*, 875 F.2d 564 (7th Cir. 1989), the Seventh Circuit affirmed a judgment holding individual shareholder and officer defendants liable for consumer restitution and other remedies to the same extent as their businesses. *Id.* at 566, 573-74. In doing so, the Seventh Circuit held that where the individuals participated in the businesses' unlawful acts, "or had authority to control them," the individuals were personally liable. *Id.* at 573. Similarly, in *Texas v. Am. Blastfax, Inc.*, 164 F.Supp.2d 892, 899 (W.D. Tex. 2001), in a state regulatory action brought under the federal Telephone Consumer Protection Act, the court held the individual officers, directors, and shareholders jointly and severally liable with the defendant corporation for monetary judgment and injunctive relief. There, the federal court rejected the defendants' proposition that individual liability for corporate acts required piercing the corporate veil, holding that those who "participate in or authorize the commission of a wrongful act, even if the wrongful act is done on behalf of the corporation, . . . may be personally liable . . . [T]o hold otherwise would allow the individual defendants to simply dissolve the [corporation], set-up a new shell corporation, and repeat their conduct." *Id.* at 897-898.

The State provided the Court with countless other examples of courts holding individual defendants liable for a business's violations under similar circumstances without requiring that the plaintiff pierce the corporate veil. *See, e.g., U.S. v. Pollution Abatement Serv., Inc.*, 763 F.2d 16, 23-25 (2nd Cir. 7985); *McCown v. Heidler*, 527 F.2d 204 (10th Cir. 1975); *Mead v. Johnson & Co. v. Baby's Formula Serv., Inc.*, 402 F.2d 19, 23 (5th Cir. 1968); *Wash v. Ralph Williams' N.W. Chrysler Plymouth, Inc.*, 553 P.2d 423, 439 (Wash. 1979).

This principle is equally established in Colorado. In *Snowden v. Taggart*, 17 P.2d 305 (Colo. 1932) the Colorado Supreme Court held that an officer of a corporation involved with the commission of the corporation's wrongdoing is personally liable, providing:

> This principle is absolutely without exception, and is founded upon the soundest legal analogies, and the wisest public policy. To permit an agent of a corporation, in carrying on its business, to inflict wrong and injuries upon others, and then shield himself from liability behind his vicarious character, would often both sanction and encourage the perpetration of flagrant and wanton injuries by agents of insolvent and irresponsible corporations.

*Id*. at 307 (internal quotations omitted).

This principle was reiterated in *Sanford v. Kobey Bros. Constr. Corp.*, 689 P.2d 724 (Colo. App. 1984), where the Court of Appeals reversed a trial court's entry of judgment in favor of an individual defendant because the facts presented did not permit the plaintiffs to pierce the corporate veil. In reaching its conclusion, the Court of Appeals provided that:

> Neither the doctrine of *respondeat superior* nor the fiction of corporate existence bars imposition of individual liability for individual acts of negligence, even when the individual is acting in a representative capacity . . . Rather, a servant may be held personally liable for his individual acts . . ., as so may an officer, director, or agent of a corporation for his or her tortious acts, regardless of the fact that the master or corporation also may be vicariously liable.

*Id*. at 725-26.

Here, it is uncontroverted that Webb is the sole manager, executive director, owner, and principal of Western Sky. It is further undisputed that Webb directs, controls, manages, participates in, supervises, is responsible for, and authorizes Western Sky's activities. Finally, the record before the Court confirms that Webb has general responsibility and final decision making authority for *all* of Western Sky's business operations. Accordingly, because Webb has

the exclusive authority to control the actions of Western Sky, he may also be held individually liable for Western Sky's violations of the Code.

To the extent that Defendants contend that "Indian businesses operating on a reservation are not subject to state jurisdiction and control" and are thus preempted by federal law, the Court is not persuaded.

Again, this very contention was rejected by this Court in its April 17, 2012 Order denying Defendants' Motion to Dismiss. As discussed above, the record before the Court confirms that Defendants' conduct does not involve the regulation of Indian affairs on an Indian reservation. Further, as discussed in the Court's April 17, 2012 Order, the Court finds the federal court's determination in *State ex rel. Suthers v. Western Sky, LLC*, 845 F.Supp.2d 1178, 1182 (D. Colo. 2011), regarding Defendants' preemption argument particularly instructive:

> Defendants argue that Congress has completely preempted the regulation of Indian affairs on a reservation. However, even if that were so, it begs the question of whether the conduct of which [the State] complain[s] involved regulation of Indian affairs on a reservation. I find and conclude that it did not. [The State] allege[s], and defendants do not dispute, that defendants were operating via the Internet . . . . The borrowers do not go to the reservation in South Dakota to apply for, negotiate or enter into loans. They apply for loans in Colorado by accessing defendants' website. They repay the loans and pay the financing charges from Colorado; Western Sky is authorized to withdraw the funds electronically from their bank accounts. The impact of the allegedly excessive charges was felt in Colorado. Defendants have not denied that they were doing business in Colorado for jurisdictional purposes, nor does it appear that they could. *See* [*Cash Advance I*, 205 P.3d at 400]. "Business conducted over the Internet that would confer jurisdiction on a state court also demonstrates that the business activity constitutes off-reservation activity." [*Id.*]

Moreover, notwithstanding the above, it is well settled that tribes are subject to state law when engaged in off-reservation activity. *See*, *e.g.*, *Nevada v. Hicks*, 533 U.S. 353 (2001); *Mescalero Apache Tribe v. Jones*, 411 U.S. 145 (1973); *Organized Vill. Of Kake v. Egan*, 369 U.S. 60, 62-63, 75-76 (1962).

C.R.S. § 5-1-201(1) provides that the Code "applies to consumer credit transactions made in this state." The Code further provides that a consumer credit transaction is made in this state if:

> (b) A consumer who is a resident of this state enters into a transaction with a creditor who has solicited or advertised in this state by any means, including but not limited to mail, brochure, telephone, print, radio, television, internet, or any other electronic means.

Code § 5-1-201(1)(b).

Here, it is undisputed that Defendants operate a website and engage in television advertising in this state, thereby soliciting and advertising their lending business in Colorado. It is further, undisputed that Defendants have entered into loan agreements with Colorado residents.

Accordingly, because Defendants' business activities are conducted off-reservation and because Defendants solicit and advertise their business in Colorado and have, in fact, entered into loan agreements with Colorado citizens, Defendants are not entitled to tribal immunity or federal preemption. Rather, based on the undisputed facts before the Court, the Court concludes that Defendants are subject to the Code's previsions and are thereby liable for any violation thereof. Specifically, because Western Sky is not, and has never been, licensed as a supervised lender, and because unlicensed lenders are not authorized to charge a finance charge on

supervised loans, Defendants' liability for restitution to consumers of all finance charges, including penalties, on all unlicensed loans made or collected with respect to Colorado citizens, is established as a matter of law.

### III. The State is entitled to Attorney's Fees incurred in Replying to Defendants' Tribal Immunity and Preemption Arguments in their Response.

The State requests that this Court grant its request for Attorney's fees pursuant to C.R.S. § 13-17-101, *et seq*., for fees incurred in replying to Defendants' tribal immunity and federal preemption arguments, raised in their Response. C.R.S. § 13-17-102 provides, in pertinent part, that a court may award reasonable attorney fees against a party who brings an action "that lacks substantial justification." *See* C.R.S. § 13-17-102(2). Under this statute, the term "lacks substantial justification" means substantially frivolous, substantially groundless, or substantially vexatious. C.R.S. § 13-17-102(4).

Here, as discussed above, the crux of Defendants' argument is that they are entitled to tribal immunity and federal preemption because their business activities are conducted on the Reservation. This very argument has been raised twice previously by these Defendants, and was rejected in each instance. Defendants first raised this argument in *Suthers*, 845 F.Supp.2d at 1182, where the federal court determined that "[D]efendants' repeated argument that [this] case involves regulation of Indian Affairs on an Indian Reservation" so lacked an "objectively reasonable basis" as to entitle the State to its costs and attorney's fees. *Id*. Defendants raised this same argument in the present litigation in their Motion to Dismiss. This argument was again rejected by this Court in its April 17, 2012 Order, denying Defendants' Motion to Dismiss. In their Response to the State's Motion for Summary Judgment, Defendants now raise this same argument for a third time, seemingly undeterred by the federal court's ruling in *Suthers*, as well

as this Court's prior ruling here. While Defendants purportedly provide additional facts concerning the details of their loan making process in support of their tribal immunity and preemption arguments, a review of the additional information provided by Defendants leads the Court to no contrary conclusion. Rather, these additional materials confirm what this Court, along with the *Suthers* court, already determined – that Defendants' actions in offering and entering into loans with Colorado consumers, via the Internet, does not constitute on-reservation business activity.

Defendants' continued assertions that they are entitled to tribal immunity and federal preemption, which have been repeatedly rejected by this Court and the Federal Courts, evince stubbornly litigious and substantially vexatious defense of this action and warrant and assessment of attorney's fees. *Mitchell v. Ryder*, 104 P.3d 316, 320-21 (Colo. App. 2004). Where, as the Court has found here, an attorney or party has brought or defended an action, or any part thereof, which lacked substantial justification, the Court shall assess attorney's fees. C.R.S. § 13-17-102(4). Any such award is properly entered in favor of the State and against Defendants and their counsel, jointly and severally. C.R.S. § 13-17-102(3).

Accordingly, because Defendants tribal immunity and federal preemption arguments lack substantial justification, the State is entitled to recover its attorney's fees expended in replying to Defendants Response insofar as the State can establish the reasonable fees incurred in addressing Defendants' tribal immunity and preemption arguments.

**CONCLUSION**

WHERFORE, in light of the reasoning stated above, the State's Motion for Partial Summary Judgment – Second Claim for Relief is hereby GRANTED. It is further ordered that,

in light of the voluminous unlicensed loans extended by Defendants in violation of the Code, estimated at over 4,000, the State's request that a special master be appointed to determine the number of, and extent to which, consumers have been adversely affected by Defendants' unlawful activity in this matter is GRANTED. The Parties shall submit a joint list of three potential Special Masters, not later than 14 days from the date of entry of this Order, and the Court will select one from that list. If the parties cannot agree on a list of potential Special Masters, the Court will appoint someone of the Court's choosing. Further, in accordance with the Court's findings herein, the State shall file an Affidavit of Attorney's fees incurred in replying to Defendants' tribal immunity and federal preemption arguments in their Response, not later than 14 days from the date of entry of this Order.

**DONE** this 15th day of April, 2012.

BY THE COURT:

MICHAEL A. MARTINEZ
District Court Judge

**STATE OF ILLINOIS**
**DEPARTMENT OF FINANCIAL & PROFESSIONAL REGULATION**
**DIVISION OF FINANCIAL INSTITUTIONS**

| | | |
|---|---|---|
| In the Matter of | ) | |
| Western Sky Financial, LLC | ) | No. 13 CC 265 |
| | ) | |

To: Western Sky Funding Group, Ltd.
612 E Street
Timber Lake, SD 57656

## CEASE AND DESIST ORDER

The DEPARTMENT OF FINANCIAL AND PROFESSIONAL REGULATION, DIVISION OF FINANCIAL INSTITUTIONS ("Department"), having conducted an examination of facts related to activities performed by Western Sky Financial, LLC ("Western Sky"), pursuant to the Payday Loan Reform Act, 815 ILCS 122/1 et seq., and the Consumer Installment Loan Act, 205 ILCS 670/1 et seq., hereby issues this order:

## STATUTORY PROVISIONS

### A. Payday Loan Reform Act ("PLRA")

1. Section 1-15(a) of PLRA states, in pertinent part:

> [T]his Act applies to any lender that offers or makes a payday loan to a consumer in Illinois. 815 ILCS 122/§1-15(a).

2. Section 1-10 of PLRA states, in pertinent part:

> "Lender" and "licensee" mean any person or entity, including any affiliate or subsidiary of a lender or licensee, that offers or makes a payday loan, buys a whole or partial interest in a payday loan, arranges a payday loan for a third party, or acts as an agent for a third party in making a payday loan, regardless of whether approval, acceptance, or ratification by the third party is necessary to create a legal obligation for the third party, and includes any other person or entity if the Department determines that the person or entity is engaged in a transaction that is in substance a disguised payday loan or a subterfuge for the purpose of avoiding this Act. 815 ILCS 122/§1-10.

3. Section 3-3(a) of PLRA states, in pertinent part:

> [A] person or entity acting as a payday lender must be licensed by the Department as provided in this Article. 815 ILCS 122/§3-3(a).

4. Section 4-10(e) of PLRA states, in pertinent part:

> The Secretary [of the Department] may issue a cease and desist order to any licensee or other person doing business without the required license, when in the opinion of the Secretary the licensee or other person is violating or is about to violate any provision of this Act or any rule or requirement imposed in writing by the Department as a condition of granting any authorization permitted by this Act. 815 ILCS 122/§4-10(e).

B. Consumer Installment Loan Act ("CILA")

5. Section 1 of CILA states, in pertinent part:

> License required to engage in business. No person, partnership, association, limited liability company, or corporation shall engage in the business of making loans of money in a principal amount not exceeding $40,000, and charge, contract for, or receive on any such loan a greater rate of interest, discount, or consideration therefor than the lender would be permitted by law to charge if he were not a licensee hereunder, except as authorized by this Act after first obtaining a license from the Director of Financial Institutions (hereinafter called the Director). 205 ILCS 670/§1.

6. Section 20.5(a) of CILA states, in pertinent part:

> The Director may issue a cease and desist order to any licensee, or other person doing business without the required license, when in the opinion of the Director, the licensee, or other person, is violating or is about to violate any provision of this Act or any rule or requirement imposed in writing by the Department as a condition of granting any authorization permitted by this Act. 205 ILCS 670/§20.5(a).

7. Section 20.5(b) of CILA states, in pertinent part:

> The Director may issue a cease and desist order prior to a hearing. 205 ILCS 670/§20.5(b).

8. Section 20.5(h) of CILA states, in pertinent part:

> The powers vested in the Director by this Section are additional to any and all other powers and remedies vested in the Director by law, and nothing in this Section shall be construed as requiring that the Director shall employ the power conferred in this Section instead of or as a condition precedent to the exercise of any other power or remedy vested in the Director. 205 ILCS 670/§20.5(h).

## FACTUAL FINDINGS

9. On or about March 6, 2013, Western Sky sent an email communication to an Illinois consumer soliciting an application for a PLRA or CILA loan.

10. On or before March 2013, Western Sky solicited applications for PLRA and CILA loans from Illinois consumers through its website, www.westernsky.com.

11. On or before March 2013, Western Sky advertised PLRA and CILA loans to Illinois consumers on multiple television networks.

12. On or before March 2013, Western Sky was engaged in the business of offering, making, or arranging PLRA loans to Illinois consumers.

13. On or before March 2013, Western Sky was engaged in the business of offering, making, or arranging CILA loans to Illinois consumers.

14. Western Sky has never been licensed by the Department to offer, make, or arrange PLRA loans to Illinois consumers.

15. Western Sky has never been licensed by the Department to offer, make, or arrange CILA loans to Illinois consumers.

## LEGAL FINDINGS

16. Western Sky violated Section 3.3 of the Payday Loan Reform Act by offering, making, or arranging PLRA loans to Illinois consumers without first applying for, and obtaining the required license from the Department.

17. Western Sky violated Section 1 of the Consumer Installment Loan Act by offering, making, or arranging CILA loans to Illinois consumers without first applying for, and obtaining the required license from the Department.

**NOW IT IS HEREBY ORDERED:**

I. Pursuant to Section 4-10(e) of the Payday Loan Reform Act, Western Sky shall immediately **CEASE AND DESIST** offering, making, or arranging PLRA loans to consumers in Illinois.

II. Pursuant to Section 20.5 of the Consumer Installment Loan Act, Western Sky shall immediately **CEASE AND DESIST** offering, making, or arranging CILA loans to consumers in Illinois.

III. Western Sky is ordered to **PRODUCE DOCUMENTS** to the Department consisting of any and all records, files, account statements, communications, and documents containing information relevant to the accounts of all active and inactive Illinois consumers. Western Sky shall provide copies of all print and electronic advertising, mailings, fliers, email communications, website pages, and any other type of solicitation or advertisement that Western Sky is using or has used to solicit consumers in Illinois. All documents requested pursuant to this paragraph shall be produced by **March 29, 2013**, and delivered to the Consumer Credit Supervisor at the Illinois Department of Financial and Professional

Regulation, Division of Financial Institutions, 100 W. Randolph Street, 9th Floor, Chicago, IL 60601.

Pursuant to Section 4-10(e) of PLRA and Section 20.5(c) of CILA, notice shall be made either personally or by certified mail. Service by certified mail shall be deemed completed when the notice is deposited in the U.S. mail. Western Sky may request, in writing, a hearing on the Order within 15 days after the date of service.

Dated this 8th day of March 2013

_____

Roxanne Nava, Director
Division of Financial Institutions

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**IN THE CIRCUIT COURT OF PULASKI COUNTY, ARKANSAS**
**_____ DIVISION**

**STATE OF ARKANSAS *ex rel.***
**DUSTIN MCDANIEL, ATTORNEY GENERAL** **PLAINTIFF**

**vs.** **CASE NO. _____**

**WESTERN SKY FINANCIAL, LLC**
**MARTIN A. WEBB**
**CASHCALL, INC.**
**WS FUNDING, LLC**
**AND J. PAUL REDDAM** **DEFENDANTS**

## COMPLAINT

Plaintiff, State of Arkansas ex rel. Dustin McDaniel, Attorney General, for its Complaint against the Defendants, states:

## INTRODUCTION

1. Defendants Western Sky Financial, LLC ("Western Sky"), Martin Webb ("Webb"), CashCall, Inc. ("CashCall"), WS Funding LLC ("WS Funding"), and J. Paul Reddam ("Reddam") (collectively "Defendants") have engaged in a scheme to originate high-interest loans to Arkansas consumers and subsequently charge and collect principal and interest in amounts prohibited by Arkansas' constitutional usury prohibition. The loans in question typically bear annual percentage rates ("APRs") ranging from 89.26% to more than 355%. For the purposes of Arkansas' usury prohibition, an APR is the substantial equivalent of a rate of "interest" as that term is defined in Arkansas. These rates of interest far exceed Arkansas' Constitutional limit of 17% per annum. It is believed that Defendants' scheme to avoid the Arkansas usury prohibition is based upon the doctrine of tribal sovereign immunity. However, their ill-conceived scheme will not avail the Defendants in this matter. While Western Sky holds itself out as a tribal entity, Western Sky is not owned by or operated by a tribe; accordingly it

cannot take advantage of the doctrine of tribal sovereign immunity. Even if the doctrine was applicable to one or more of the Defendants, the underlying illegal loan transactions would still be void and unenforceable. Further, Defendants CashCall, WS Funding, and J. Paul Reddam are neither tribal members nor tribal entities, and are not located on tribal lands, nor even in the same state as Western Sky and the tribe to which it claims affiliation.

**PARTIES**

2. Plaintiff is the State of Arkansas *ex rel.* Dustin McDaniel, the Attorney General for the State of Arkansas. This is a consumer protection action. This complaint is brought in the public interest in order to redress and restrain violations of the Arkansas Deceptive Trade Practices Act, Ark. Code Ann. § 4-88-101 through 115, and the Arkansas Constitution, Amendment 89, formerly Article 19, Section 13, prohibiting usury in the State of Arkansas.

3. Defendant Western Sky Financial, LLC ("Western Sky") is a limited liability company organized under the laws of South Dakota with a principal place of business at 612 E St., Timber Lake, South Dakota 57656. Western Sky's South Dakota registered agent is Martin A. Webb, also at 612 E St., Timber Lake, South Dakota 57656. Western Sky is not registered with the Arkansas Secretary of State. According to Western Sky's website, "Western Sky Financial is owned wholly by an individual Tribal Member of the Cheyenne River Sioux Tribe and is not owned or operated by the Cheyenne River Sioux Tribe or any of its political subdivisions."

4. Defendant Martin A. Webb ("Webb"), a/k/a Butch Webb, is a resident of South Dakota. Webb is the sole owner, officer, and registered agent of Western Sky.

5. Defendant CashCall, Inc. ("CashCall") is a corporation organized under the laws of California with a principal place of business at 1600 South Douglass Road, Anaheim, CA

92806. CashCall is registered with the Arkansas Secretary of State and its registered agent is National Registered Agents, Inc., at 1900 W. Capital Ave., Ste. 1900, Little Rock, AR 72201

6. WS Funding, LLC ("WS Funding") is a Delaware limited liability company and a wholly-owned subsidiary of CashCall. WS Funding was incorporated in Delaware on March 15, 2010. The President of WS Funding, Paul Redham, is also the President and owner of CashCall. It's Delaware registered agent is RL&F Service Corp., 920 N. King St. Fl. 2, Wilmington, DE, 19801. WS Funding is not registered with the Arkansas Secretary of State.

7. J. Paul Reddam is the president of CashCall, the sole member of that company's Board of Directors, and that company's only owner. Reddam is also the president of WS Funding.

8. As more fully set out in the Complaint, Defendants Webb and Reddam, the sole owners of their respective Defendant companies, orchestrated the companies' scheme to originate and collect on usurious loans, including executing the agreements that established the scheme. Webb and Reddam are therefore individually liable for the unconscionable and otherwise unlawful acts and practices described below. Defendants are "controlling persons" within the meaning of Ark. Code Ann. § 4-88-113(d).

## JURISDICTION AND VENUE

9. This Court has jurisdiction over this matter pursuant to Ark. Code Ann. § 4-88-104 and Ark. Code Ann. § 16-4-101(B), which provides: "The courts of this state shall have personal jurisdiction of all persons, and causes of action or claims for relief, to the maximum extent permitted by the due process clause of the Fourteenth Amendment of the United States Constitution." Defendants Western Sky, CashCall, and WS Funding have transacted business in the State of Arkansas by soliciting loans in Arkansas and originating loans to Arkansas

consumers by depositing funds in Arkansas consumers bank accounts located in Arkansas. In addition, CashCall and WS Funding have transacted business in Arkansas by systematically purchasing the loans of Arkansas consumers days after the origination and funding of such loans, servicing those loans, including repeatedly debiting the bank accounts of numerous Arkansas consumers within Arkansas and otherwise attempting to collect money from Arkansas consumers, and establishing continuing business relationships with Arkansas consumers. Based upon their activities in the State of Arkansas, the Defendants should reasonably expect to defend themselves in the courts of this State for violations of applicable laws.

10. Venue is proper pursuant to Ark. Code Ann. § 4-88-104, § 4-88-112, and the common law of the State of Arkansas. As more fully set out below, the Defendants have engaged in numerous and repeated business transactions in the State of Arkansas.

## BUSINESS PRACTICES OF THE DEFENDANTS

11. Western Sky, CashCall, and WS Funding are in the business of originating, funding, and collecting high-interest loans to borrowers across the nation, including Arkansas.

12. As of the date of this filing, the Arkansas Attorney General's Office has received approximately 100 complaints about high-interest loans made to Arkansas consumers by these companies. The total number of loans made to residents of the State of Arkansas is, as of yet, unknown.

### *The business arrangement between CashCall, WS Funding, and Western Sky*

13. On February 1, 2010 WS Funding, a CashCall subsidiary, entered into an "Agreement with Western Sky Financial for the Assignment and Purchase of Promissory Notes." The agreement is signed on behalf of WS Funding by CashCall's owner and president, Defendant

Reddam, and on behalf of Western Sky by Defendant Webb. See Exhibit 1 for a copy of the agreement.

14. An agreement identical to the 2010 agreement was executed on December 28, 2009 between WS Financial, a CashCall subsidiary, and Western Sky. The 2009 agreement was also signed by Defendants Reddam and Webb. See Exhibit 2 for a copy of the 2009 agreement.

15. Pursuant to these agreements, CashCall and its subsidiaries bear all the risk of nonpayment on the loans.

16. Per the agreements, Western Sky originates the loans to Arkansas consumers, but then promptly assigns the loans to WS Funding. Western Sky warrants to WS Funding that borrowers will not have made any payments on the loans before the loan's purchase by, and assignment to WS Funding. WS Funding then assumes all rights of Western Sky to collect on the loans.

17. Per the agreements, WS Funding agrees to purchase all of the loans originated by Western Sky through its web site, www.westernsky.com. But, as noted in more detail below, the web site and the transactions occurring through that web site are substantially, if not entirely, controlled by CashCall, its subsidiary WS Funding, and Reddam.

18. Per the agreements, after assignment, WS Funding assumes all of the rights of Western Sky and all collection responsibilities.

19. Per the agreements, CashCall and its subsidiaries agree to indemnify Western Sky for "all costs arising or resulting from any and all civil, criminal or administrative claims or actions, including but not limited to fines, costs, assessments and/or penalties" and attorney's fees. See paragraph 11 of both the 2009 and 2010 agreement.

20. CashCall and its subsidiaries run virtually every aspect of Western Sky's operations. By an agreement between CashCall and Western Sky, titled "Agreement for Service" and dated January 9, 2010, CashCall agreed to provide the following:

- Inbound/Outbound Customer Service Support;
- Underwriting requirements review
- Marketing services
- Lead purchase
- Web site hosting and support
- Assignment of a toll free phone and fax number.
- Electronic communication such as email and test correspondence with customers.
- Mailings, including postage and materials

The Agreement for Service is attached as Exhibit 3. It is signed on behalf of CashCall, Inc. by J. Paul Reddam and Butch Webb for Western Sky.

21. In addition, Western Sky grants to CashCall the right to use its artwork, designs, trademarks, slogans, logos and other advertising material to engage in advertising online, on television, on the radio and in print.

22. A previous "Agreement for Service" dated December 28, 2009 between WS Financial, LLC, a subsidiary of CashCall, and Western Sky is nearly identical to the "Agreement for Service" signed on January 9, 2010. The 2009 Agreement for Service is attached as Exhibit 4. It is also signed by J. Paul Reddam and Butch Webb.

23. Finally, pursuant to a Promissory Note dated December 28, 2009, Defendant CashCall and its subsidiaries provided a $500,000 line of credit to be used by Western Sky to run its operations. The Promissory Note is attached as Exhibit 5.

24. The website www.westernsky.com is registered to Webb, through another of his LLC's, Payday Financial, LLC. However, the "800" number listed on the website for use in applying for a loan by phone is registered to CashCall. The "800" numbers for questions about your application and faxing loan approval related documents are also registered to CashCall.

***The loans***

25. As set forth on the website www.westernsky.com, loans have been offered to Arkansas consumers with principal amounts that range from $850 to $10,000 and bearing annual percentage rates of between 89.68% and 342.86%.

26. The following chart was taken from www.westernsky.com:

| Product | Borrower Proceeds | Loan Fee | APR | Number of Payments | Payment Amount |
|---|---|---|---|---|---|
| $10,000 | $9 925 | $75 | 89.68% | 84 | $743.49 |
| $5,075 | $5,000 | $75 | 116.73% | 84 | $486.58 |
| $2,600 | $2,525 | $75 | 139.22% | 47 | $294.49 |
| $1,500 | $1,000 | $500 | 234.25% | 24 | $198.19 |
| $850 | $500 | $350 | 342.86% | 12 | $150.72 |

27. Arkansas consumers apply for and sign loan documents while physically located in Arkansas, using computer terminals in Arkansas. Arkansas consumers do not travel to South Dakota, much less the Cheyenne River Sioux reservation in South Dakota, to apply for a loan, to sign the loan agreement, or to pick up the loan proceeds. Instead, Western Sky funds the loans by depositing money directly into Arkansas consumers' bank accounts located in Arkansas by way of electronic transfer. Exhibit 6 contains emails from Western Sky to an Arkansas consumer concerning the origination process of these loans.

28. Attached are several lending agreements entered into between Western Sky and Arkansas consumers. Exhibits 7, 8, and 9. The interest rates disclosed on the face of these agreements are well in excess of Arkansas' Constitutional limits.

29. The loans funded and collected on by the Defendants are extremely expensive. A borrower that receives $1,000 in principal is required to repay more than $4,000 in finance charges, fees, and principal over two years; a borrower that receives $2,525 is required to repay approximately $14,000 over four years; and for $9,925 a borrower is required to repay approximately $60,000 over seven years.

***Defendants Collect Usurious Rates of Interest***

30. All of the Arkansas loans which appear to have been originated by Western Sky are purchased by, and assigned to, CashCall's subsidiary, WS Funding. The assignments are made shortly after the loans are approved, typically within three days.

31. Following the assignment of a loan to WS Funding, CashCall contacts the borrower by e-mail or letter to notify the borrower that the loan has been assigned to WS Funding. See Exhibit 10 attached for an example of two of these notices, which were sent to Arkansas consumers.

32. The notice states that "Going forward, CashCall will handle the servicing of your loan, which means collecting your payments and handling related issues." Further the notice says that all payments will be made to CashCall.

33. After providing the aforementioned notice, CashCall proceeds to electronically debit, via the ACH network, monthly payments from Arkansas consumers' bank accounts.

34. CashCall, and its subsidiaries, have electronically debited an unknown, but substantial, number of payments directly from Arkansas borrowers' bank accounts.

**VIOLATIONS OF THE ARKANSAS DECEPTIVE TRADE PRACTICES ACT**

35. The business practices of the Defendants constitute the sale of "goods" or "services" within the meaning of Ark. Code Ann. § 4-88-102(3) and (6). The same business practices constitute business, commerce, or trade within the meaning of Ark. Ann. § 4-88-107.

36. The conduct engaged in by Defendants constitutes deceptive and unconscionable trade practices prohibited by the Arkansas Deceptive Trade Practices Act. The prohibited practices engaged in by the Defendants include, but likely are not limited to, violations of Arkansas Code Ann. §§ 4-88-107(a)(1) and 4-88-107(a)(10). More specifically, the Defendants have violated and continue to violate the Arkansas Deceptive Trade Practices Act by:

(a) Charging and collecting unconscionable rates of interest in lending transactions. The practice of charging ultra-high usurious rates of interest is unconscionable as a matter of law and violates the Arkansas Constitution. See *State of Ark. v R & A Investment Co., Inc.*, 336 Ark. 289, 785 SW 2d 299 (1999), *Arkansas Board of Collection Agencies and Old Republic Surety Company v. Mcghee, et al.,* 372 Ark. 136, 271 S.W.3d 512 (2008), S*taton v Arkansas Board of Collection Agencies and American Manufactures Mutual Insurance Company*, 372 Ark. 387, 277 S.W.3d 190 (2008), and *McGhee v. Arkansas State Bd. of Collection Agencies*, 375 Ark. 52, 289 S.W.3d 18 (2008).

**RELIEF REQUESTED**

37. The acts and practices of the Defendants constitute violations of the Arkansas Deceptive Trade Practices Act, and the Plaintiff hereby seeks, the following relief:

(a) Injunction – Pursuant to Ark. Code Ann. § 4-88-113(a)(1), the Court should enter such orders or judgments as may be necessary to prevent the use or employment by the Defendants of the practices described herein which are violations of the Arkansas Deceptive Trade Practices Act and the Arkansas Constitution, Amendment

89, formerly *Article 19, Section 13* . In addition to enjoining ongoing violations of Arkansas law, Plaintiff prays that this Court cancel all outstanding loan contracts together with any obligations to which any consumers may be arguably be subject based upon such contracts, prohibit any action on the part of the Defendants or their agents to collect any sums arguably due, prohibit the Defendants from selling or transferring the loans to any third party, and require the Defendants to remove any negative credit reports made by the Defendants, or their agents, to any credit reporting agency.

(b) Restitution – Pursuant to Ark. Code Ann. § 4-88-113(a)(2), this Court should enter such orders or judgments as may be necessary to restore to any person who has suffered any ascertainable loss by reason of the use of prohibited practices any monies which may have been acquired by the Defendants, together with any other damages which these consumers may have sustained. All payments made by any affected Arkansas consumer, whether demoninated as principal or interest, or otherwise, should be restored to the borrower. In addition, or in the alternative, the Defendant should be ordered to disgorge all funds received from borrowers in these unconscionable lending transactions.

(c) Civil Penalties – Pursuant to Ark. Code Ann. § 4-88-113(a)(3), the Plaintiff seeks the imposition of civil penalties to be paid to the State. Plaintiff seeks civil penalties against the Defendant in the amount of $10,000 for each violation of the Arkansas Deceptive Trade Practices Act. Each unconscionable lending transaction is a violation of the Arkansas Deceptive Trade Practices Act. The total recovery sought by the Plaintiff for restitution, disgorgement, and civil penalties is in an amount in excess of that required for federal court jurisdiction in diversity of citizenship cases.

(d) Attorneys fees and costs – Pursuant to Ark. Code Ann. § 4-88-113(e), the Plaintiff seeks the reimbursement of all expenses reasonably incurred in the investigation and prosecution of this matter, together with attorneys fees and costs.

WHEREFORE, Plaintiff prays that this Court permanently restrain the Defendants from engaging in acts which constitute violations of the Arkansas Deceptive Trade Practices Act and are prohibited by the Arkansas Constitution; that all outstanding loans be voided; that the Defendants be barred from taking any action to enforce or otherwise collect any lending agreement; that the Defendants be ordered to pay restitution to all affected Arkansas consumers consisting of all payments made by such consumers, together with any other damages sustained by such consumers; alternatively, or in addition, that the Defendants be ordered to disgorge all payments received from Arkansas consumers; that the Defendants be assessed civil penalties; that the Plaintiff be awarded from the Defendants reimbursement for all expenses reasonably incurred in the investigation and prosecution of this matter, together with reasonable attorneys fees and costs, and for all other relief to which the Plaintiff may be entitled.

Respectfully submitted,

DUSTIN MCDANIEL,
Attorney General

By: Charles Saunders

Charles Saunders
Assistant Attorney General
Arkansas Bar No. 03117
Assistant Attorney General
500 Catlett-Prien Tower Building
323 Center Street
Little Rock, Arkansas 72201-2610
501-683-1501

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

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| DEBORAH JACKSON, et al., | ) | |
| | ) | |
| Plaintiff-Appellants, | ) | |
| | ) | |
| vs. | ) | 11 C 9288 |
| | ) | |
| PAYDAY FINANCIAL, LLC, et al., | ) | |
| | ) | |
| Defendant-Appellees. | ) | |

**DISTRICT COURT'S RESPONSE TO COURT OF APPEALS REMAND FOR FINDINGS OF FACT**

The United States Court of Appeals has remanded two questions to this Court while still retaining jurisdiction of the case. This Court has been asked to make findings of fact as to the following:

1. Whether the Cheyenne River Sioux Tribe has applicable tribal law readily available to the public and, if so, under what conditions; and

2. Whether the Cheyenne River Sioux Tribe has an authorized arbitration mechanism available to the parties and whether the arbitrator and method of arbitration required under the contract is actually available.

The parties were asked to submit their own responses to these questions with any documentary exhibits or attachments they desired to accompany their responsive legal briefs. Each party was content to rely on its submissions without the conduct of additional discovery or presentation of testimony. It is on that record that this Court

has prepared the requested findings of fact. The parties' submissions shall accompany the Court's findings of fact.

As to the question of whether there is applicable tribal law readily available to the public, the parties' submissions differ. After a number of failed attempts, the Plaintiffs acknowledged having obtained a copy of the tribe's 1978 Law and Order Code at a cost of $125 from the National Indian Law Library. Defense counsel avers that a copy of the Cheyenne River Sioux Tribal Code was requested by telephone from the National Indian Law Library and received without any payment required, along with PDF copies of Tribal Resolutions and Ordinances enacted between 1981 and 2000, including the Tribe's Commercial Code.

It is this Court's finding that the answer to the first of the remanded questions is in the affirmative. Each party was able to secure a copy of the Tribal Law, although the Plaintiff's did so less readily. Nevertheless, we believe the law can be acquired by reasonable means.

The second of the remanded questions requires consideration of multifaceted aspects of the concept of arbitration and its mechanisms, and its actual availability to the parties before the Court.

Claims relating to Defendants' loans have been the subject of only one arbitration proceeding which is currently pending. That arbitration is the subject of the case entitled *Inetianbor v. Cash Call, Inc.* No. 13 CV 60066 (S.D. Fla. 2013). The

procedural history of that case and relevant associated materials are included in the Plaintiff's submissions. That lawsuit involved a loan of $2,525 for three years with the total payments due under the contract of $11,024.82. As the contract states, the cost of the credit at a yearly rate was 139.31%. By anybody's definition, this is a usurious rate of interest.

The arbitrator selected in the *Inetianbor* case was Robert Chasing Hawk, a Tribal Elder. He was personally selected by Martin Webb, the man who owns and operates the Webb entities which are run as a common enterprise. Mr. Webb is himself a member of the Tribe. Although denying any preexisting relationship with either party in the case, Robert Chasing Hawk is the father of Shannon Chasing Hawk. Robert Chasing Hawk has acknowledged that his daughter worked for one of the companies run by Martin Webb.

Mr. Chasing Hawk is not an attorney and has not been admitted to the practice of law either in South Dakota or the court of the Cheyenne River Sioux Tribal Nation. He has not had any training as an arbitrator and the sole basis of his selection was because he was a Tribal Elder.

Black's Law Dictionary, DeLuxe Fourth Edition, defines "arbitrator" as "a private, disinterested person, chosen by the parties to a disputed question, for the purpose of hearing their contention, and giving judgment between them; to whose decision (award) the litigants submit themselves either voluntarily, or, in some cases,

compulsorily by order of a court." Freedom from bias and prejudice is a stated criteria of the American Arbitration Association's Criteria to serve as an arbitrator. Similar is JAM's Arbitrators Ethics Guidelines which requires freedom from any appearance of a conflict of interest. Illinois Supreme Court Rule 62 states, in part, that "a judge should respect and comply with the law and should conduct himself or herself at all time in a manner that promotes public confidence in the integrity and impartiality of the judiciary. A judge should not allow the judge's family, social or other relationships to influence the judge's judicial conduct or judgment." It should be no less for an arbitrator.

The selection of Robert Chasing Hawk as the arbitrator in the only comparable case is instructive. No arbitration award could ever stand in the instant case if an arbitrator was similarly selected, nor could it satisfy the concept of a "method of arbitration" available to both parties. The selection of Chasing Hawk in the *Inetianbor* case was a purely subjective selection by only one of the parties to the arbitration. The process was not "methodized" in any reasonable sense of the word. Webb and Chasing Hawk are members of the same tribe. The Plaintiffs are not. The employment by Webb of the arbitrator's daughter cannot be ignored. The conduct permitted by the arbitration provisions in this case could never satisfy the straightforward definition in Black's Law Dictionary.

Equally telling about Payday Financial LLC, Cash Call, Inc., and the Webb Entities operations is the State of New Hampshire Banking Department's Cease and Desist Order. The Department first conducted a routine examination of Cash Call. This was followed by the issuance of an administrative subpoena duces tecum to Cash Call seeking a variety of documents related to Cash Call's relationship with Western Sky. Cash Call complied and produced the requested documents.

Among other findings made by the Department, it determined that the respondents were engaged in a business scheme and took substantial steps to conceal the business scheme from consumers and state and federal regulators. The findings included the fact that Western Sky was nothing more than a front to enable Cash Call to evade licensure by state agencies and to exploit Indian Tribal Sovereign Immunity to shield its deceptive practices from prosecution by state and federal regulators. The Department found a reasonable basis to believe the business scheme described constituted an unfair or deceptive act or practice used as a shield to evade licensure from the Department by exploiting Indian Tribal Sovereign Immunity.

While this Court recognizes that no trial has been held to permit a full exposition of all relevant facts, each party was afforded the opportunity to present whatever evidence it wished. It is abundantly clear that, on the present record, the answer to the

second question is a resounding no. Other than this Court's disagreement with Plaintiffs' position as to the availability of tribal law, pages 8 through 10 of "Plaintiffs' Statement of Relevant Facts, and On Further Discovery Required on Limited Remand by Court of Appeals" fairly describe what the facts show. The scheme described in the New Hampshire Banking Department's Cease and Desist Order has been apparently devised for the purpose of evading federal and state regulation of Defendants' activities. The intrusion of the Cheyenne River Sioux Tribal Nation into the contractual arbitration provision appears to be merely an attempt to escape otherwise applicable limits on interest charges. As such, the promise of a meaningful and fairly conducted arbitration is a sham and an illusion.

We respectfully submit our responses to the questions posed.

Charles P. Kocoras
United States District Judge

Dated: August 28, 2013