STATE OF NORTH CAROLINA

WAKE COUNTY

IN A MATTER
BEFORE THE COMMISSIONER OF BANKS
DOCKET NO: 05:008:CF

IN RE:	)	
	)	
ADVANCE AMERICA, CASH	)	
ADVANCE CENTERS OF NORTH	)	**ORDER**
CAROLINA, INC.	)	
	)	

THIS MATTER came before the Commissioner of Banks ("Commissioner") pursuant to N.C. Gen. Stat. § 150B-38(b) and 4 NCAC 3B .0200, *et seq.*, upon a Notice of Hearing and Mandatory Pre-Hearing Conference dated February 1, 2005 and the Amended Notice of Hearing dated July 11, 2005.

This matter was instituted to determine whether certain business activities of Advance America Cash Advance Centers of North Carolina, Inc. ("AANC" or "Respondent") violated applicable North Carolina law and, if so, to order appropriate remedies. Based on a review of the entire record[1] in the matter and of applicable legal and regulatory authority, I find in this Order that (i) AANC's business conduct as the purported marketing, processing and servicing agent of certain out-of-state banks violates the North Carolina Consumer Finance Act, Article 15 of Chapter 53 of the North Carolina General Statutes, N.C. Gen. Stat. §§ 53-164 *et seq.* (the "Consumer Finance Act" or "CFA"); (ii) AANC is not exempt from the provisions of the Consumer Finance Act pursuant to the terms of the statute itself or to any other constitutional or legal authority; and (iii) the Office of the North Carolina Attorney General ("OAG") and the Office of the North Carolina Commissioner of Banks ("OCOB") are not estopped to enforce the CFA against AANC. On the basis of these findings, I order hereinafter that AANC cease and desist from the conduct of its business in North Carolina. My factual findings, legal analysis and conclusions, and order to AANC are set forth below.

[1] The evidence in this case, from which the findings of fact are taken, includes, but is not limited to, five primary parts: 1) The Commissioner's Evidence, consisting of numbered documents which I have entered on my own motion, hereinafter referred as "Commissioner's Exhibits;" 2) Petitioners' Stipulations and Exhibits/Petitioners' Supplemental Exhibits, consisting of numbered documents submitted by the OCOB and the OAG, hereinafter referred to as "Petitioners' Exhibits;" 3) Exhibits in Support of Respondent's Post-Hearing Memorandum, numbered documents submitted by AANC's lead counsel, hereinafter referred to as "Respondent's Exhibits; 4) a stack of unnumbered documents, affidavits, and deposition transcripts, submitted by AANC's co-counsel, hereinafter referred to as "Unindexed Exhibits;" and 5) stipulations signed by counsel for all parties. A full description of the evidence is found in the Final Order Regarding Admissibility of Evidence, dated December 19, 2005.

I. FINDINGS OF FACT

AANC and Its Corporate Affiliates

AANC is a Delaware corporation.[2] From and after October 1, 1997, AANC conducted business operations in North Carolina.[3] During this period of time, AANC has operated as many as 118 cash advance centers in North Carolina.[4] On September 14, 2005, AANC's parent company announced that the bank for which AANC was marketing, processing and servicing payday cash advances and installment loans had temporarily suspended its loan originations in North Carolina and that the company anticipated that such suspension would continue at least until the issuance of a ruling in this matter.[5]

AANC is the wholly-owned subsidiary of Advance America, Cash Advance Centers, Inc. ("Parent"),[6] a Delaware corporation. Parent is the largest provider of payday cash advance services in the United States, as measured by the number of payday cash advance centers operated.[7] Parent does business in 34 states, operating through wholly-owned subsidiaries in each of such states.[8] The sole business of Parent, through its subsidiaries, is either the making or the processing, marketing and servicing of payday cash advance transactions.[9]

Parent, through its wholly-owned subsidiaries, conducts its business through either a standard business model or an agency business model.[10] Under the standard business model, payday cash advances are offered and made by Parent, through a wholly-owned subsidiary, directly to its customers.[11] Under the agency business model, payday cash advances are made pursuant to processing, marketing and servicing agreements between subsidiaries of Parent and out-of-state, state-chartered banks.[12] Parent conducted operations, through AANC, in North Carolina under the standard business model from October 31, 1997 through August 31, 2001, and the agency business model thereafter.[13]

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[2] Pre-Hearing Stipulations, dated May 20, 2005 ("PHS"), Stipulation of Facts ("SF") No. 1.
[3] PHS SF Nos. 8, 15-18 (operations of AANC and McKenzie Check Advance of North Carolina, LLC (which was acquired by AANC's Parent in 1999 and consolidated with AANC) for the period October 1, 1997 through August 31, 2001); PHS SF Nos. 23, 32, 33 (operations from September 1, 2001, through July 6, 2005); Petitioners' Exhibit 87 (operations from July 6, 2005, to September 15, 2005).
[4] PHS SF No. 3.
[5] Periodic Report on Form 8-K, dated September 14, 2005, of Advance America, Cash Advance Centers, Inc., *available at* http://www.sec.gov/Archives/edgar/data/1299704/000110465905044205/a05-16288_18k.htm.
[6] PHS SF No. 4.
[7] PHS SF No. 7.
[8] PHS SF No. 5.
[9] PHS SF No. 6.
[10] PHS SF No. 5.
[11] PHS SF No. 9
[12] PHS SF No. 11.
[13] PHS SF No. 3.

AANC is operated under the supervision and control of a "Zone Director" of the Parent, who reports to the President of the Parent and who is responsible for oversight and management of all AANC locations.[14] At all times since September 30, 1997, AANC has received corporate supervision and support services from the Parent under a Management Agreement between AANC and Parent (the "Management Agreement").[15] Pursuant to the Management Agreement, the services to be performed by Parent "as agent for the Company" (that is, for AANC) include:

1. Supervision of professionals in corporate qualification to do business in state,

2. Recommend Branch site locations and conduct lease negotiations,

3. Supervise new Branch construction and opening,

4. Marketing and advertising coordination,

5. Provide personnel for District and Regional operations management and procedures for daily Branch operations,

6. Payroll and payroll tax services (through a third party service company as selected by the Parent),

7. Provide personnel and procedures for management of Human Resources,

8. Benefit program (medical, life and AD&D insurances; 401(K); other as requested by AANC) implementation and maintenance,

9. MIS support, including but not limited to, (1) hardware and software decisions and purchases, and (2) help desks,

10. Treasury services, including, but not limited to, bank relations (account establishment, loans, etc.), cash management, and lease versus buy evaluations,

11. Accounting services, including, but not limited to:
    A. General ledger maintenance,

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[14] Prospectus, filed pursuant to Securities and Exchange Commission Rule 424(b)(1), of Advance America, Cash Advance Centers, Inc. (the "Prospectus"), that is included in the record of this matter as Petitioners' Exhibit 2 and Respondent's Exhibit 78, pp. 83, 84; Affidavit of Jennifer Rodriguez, dated August 2, 2005, and included in the record of this matter as Respondent's Exhibit 10. Prospectus *available at* http://www.sec.gov/Archives/edgar/data/1299704/000104746904037527/a2148783z424b1.htm.

[15] Management Agreement, dated September 30, 1997, between Advance America, Cash Advance Centers, Inc. and Advance America, Cash Advance Centers of North Carolina, Inc., comprising Exhibit 1 to letter from AANC counsel to the Commissioner, dated December 17, 2004, and included in the record of this matter as Respondent's Exhibit 75 [hereinafter Management Agreement].

B. Internal and external financial reporting,
C. Bank account reconciliations,
D. Fixed asset accounting and ledger maintenance,
E. Accounts payable accounting and payment, and
F. Tax accounting, compliance and planning for federal, state and local jurisdictions.

12. Legal services coordination,

13. Risk management, including, but not limited to, (1) security, and (2) insurance coverage and policy negotiation, and

14. Other general management services as determined necessary by the Parent or as requested by AANC.[16]

In consideration of the performance of these services by Parent for AANC, AANC is obligated to pay to Parent "an amount equal to 10.0% of monthly revenues" as a management fee for which Parent would invoice monthly, and to pay to Parent all direct expenses incurred by Parent for AANC.[17]

Under the Management Agreement, Parent also provided financing for AANC through cash advances and working capital loans.[18] Such advances or loans bear monthly interest at "NationsBank prime interest rate at the beginning of the calendar month" applied to 90% of the average amount of such advance or loan outstanding at the beginning and end of the month.[19]

AARC, Inc. ("AARC"), another subsidiary of Parent, owns all of the Parent's intellectual property, including trademarks, logos and other such property.[20] Each operating subsidiary of Parent, including AANC, has access to such intellectual property only through a licensing agreement with AARC.[21] AANC and other operating subsidiaries of Parent utilize the Parent's proprietary computer information system, known as "Advantage," to record and transmit information solicited from a loan customer at each branch location, and Parent retains total control over this information system under both the standard and agency business models.[22]

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[16] *Id.* ¶ *1.*
[17] *Id.* ¶ *2.*
[18] *Id.* ¶¶ 2-3.
[19] *Id.*
[20] Prospectus, *supra* note 14, p. 85.
[21] *Id.*
[22] *Id.* pp. 81, 82.

In its financial statements, Parent accounts for the income generated by its business activities as follows:[23]

1. Total Revenues is comprised of (i) fees and interest charged to customers and (ii) processing, marketing and servicing fees. Item (i) of Total Revenues represents the direct charges to customers in standard business model states; item (ii) the charges to banks in agency business model states.

2. Provision for doubtful accounts and agency bank losses is subtracted from Total Revenues to determine Net Revenues. Provision for doubtful accounts relates to standard business model states; provision for agency bank losses relates to agency business model states.

3. Total Center Expenses are subtracted from Net Revenues to determine Center Gross Profit. Total Center Expenses is comprised of (i) salaries and related payroll costs; (ii) occupancy costs; (iii) center depreciation expense; (iv) advertising expense; and (v) other center expenses. Center Gross Profit represents the operating results of cash advance centers operated by Parent through its various subsidiaries.

4. Corporate and Other Expenses (Income) are subtracted from Center Gross Profit to determine Income Before Income Taxes. Corporate and Other Expenses is comprised of: (i) general and administrative expense; (ii) corporate depreciation expense; (iii) amortization expense; (iv) options purchase expense; (v) interest expense (net of interest income); and (vi) loss on disposal of property and equipment.

5. Net income is determined by subtracting Income Tax Expense from Income Before Income Taxes.

It is not clear from Parent's financial statements how the costs of advances from the Parent to AANC are accounted for. For purposes of this Order, it will be assumed that the interest charged and paid to Parent under the Management Agreement is included in Other Center Expenses.

[23] Prospectus, *supra* note 14, p. 41 (for North Carolina centers); *Id.* pp. 52-56 (for Parent on a consolidated basis).

Payday Cash Advances

Payday cash advances are advances of cash, typically for a period of approximately 14 days, in exchange for a check drawn on the consumer's bank account in an amount equal to the amount of the cash advance plus applicable fees and / or interest.[24] As part of business operations under the agency business model, such advances were made either through issuance of a bank check or from cash of the bank held by AANC.[25] In all instances relevant to this matter, the fee for such payday cash advances is not less than $15 per $100 advanced.[26] Advances of this kind are hereinafter referred to as "Advances."

Advances are considered consumer loans for purposes of bank regulatory and financial accounting, and fees are treated as interest for such purposes.[27] Advances are subject to applicable federal regulation relating to consumer loans, including the Truth in Lending Act, Equal Credit Opportunity Act, Fair Credit Reporting Act, and Gramm-Leach-Bliley Act, and the regulations thereunder.[28]

Treatment of Advances under North Carolina Law

Prior to October 1, 1997, the making of Advances was not expressly permitted by North Carolina law.[29] Short term loans of all kinds were subject to the North Carolina Consumer Finance Act and North Carolina's usury law.[30]

On October 1, 1997, the North Carolina Check Cashing Act[31] became effective. Section 53-281 of that statute permitted Advances in exchange for a borrower's check in a face amount of no more than $300 (including authorized fees), for terms not to exceed 31 days, at fees not to exceed 15% of the face amount of the check and subject to further limitations and requirements.[32] Advances under the statute could only be made by persons or entities licensed as check cashers.[33]

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[24] PHS SF Nos. 10, 12.

[25] PHS SF Nos. 27, 28; Respondent's Pre-Hearing Stipulations ("RPHS"), dated September 2, 2005, Nos. 49, 50 and 51. For Peoples National Bank ("PNB") transactions, only a check was issued. Letter of Counsel for AANC to Commissioner, December 17, 2004, Petitioners' Exhibit 31, item no. 28. For Republic Bank & Trust Company ("RBT") transactions, a check was issued that was sometimes immediately converted to cash. Petitioners' Exhibit 11, p. B-5 and Petitioners' Exhibit 13. First Fidelity Bank ("FFB") transactions followed the same pattern as RBT, Petitioners' Exhibit 62, p. B-7.

[26] PHS SF Nos. 19, 29, 35. For RBT, Petitioners' Exhibit 7, 19. For FFB, Petitioners' Exhibit 51.

[27] Securities Exchange Act Registration Statement on Form 10-K of Republic Bancorp, Inc. for the Fiscal Year ended December 31, 2004 ("Republic 2004 10-K"), included in the record of this proceeding as Commissioner's Exhibit 7, pp. 28-29, 65. The Republic 2004 10-K is available on-line at: http://www.sec.gov/Archives/edgar/data/921557/000110465905011522/a05-1744_110k.htm. *See also*, Prospectus, *supra* note 14, p. F-9 ("Revenues on payday cash advances can be characterized as fees and / or interest depending upon certain state laws.").

[28] Prospectus, *supra* note 14, p. 90.

[29] Opinion of North Carolina Attorney General, Commissioner's Exhibit 16.

[30] *See* discussion of CFA legislative history *infra* text accompanying notes 211-213.

[31] Session Laws 1997-391.

[32] *Id.*; *see also* OCOB Declaratory Ruling, dated November 30, 1998, at http://www.nccob.org/NR/rdonlyres/86909C76-A60E-4D8D-A81B-

As enacted, G.S. § 53-281 had a "sunset date" of July 31, 2001.[34] The 2001 Session of the General Assembly considered extension of that provision and did so for thirty days but not longer.[35] On August 31, 2001, G.S. § 53-281 expired by its terms.

Since August 31, 2001, the North Carolina General Assembly has considered legislation to expressly permit the making of Advances in each of its legislative sessions.[36] No such legislation has been adopted.

Conduct of Business by AANC

AANC commenced operations in North Carolina in 1997, after the effective date of the Check Cashers Act, and it has operated in this state continuously since that time until the suspension of business discussed above.[37] Its operations were conducted in the manner described below.

AANC Operates on its Own: October 1, 1997 to August 31, 2001

During the effectiveness of G.S. § 53-281, from October 1, 1997 to August 31, 2001, AANC operated under the standard business model.[38] Advances made during this period are hereinafter referred to as "AANC Advances." AANC was licensed as a check casher and made AANC Advances from its own funds.[39] An AANC customer who had no funds in his or her checking account could write a check to AANC and receive an immediate cash advance.[40] The maximum fee for such a transaction in North Carolina was 15% of the face amount of the check, with maximum face amount (loan plus fees) of $300.[41] In a typical transaction, an AANC customer would write a check for $117, which was made payable to AANC and receive $100 in cash.[42] The effective annual percentage rate for such a transaction, repayable in 14 days, was 443.21%.[43]

75D36CDD60EF/0/DeclaratoryRuling_CheckCashersAct.pdf and OCOB Regulations at 4 N.C.A.C, Subchapter 3L.

[33] G.S. § 53-276.

[34] Session Law 1997-391.

[35] Session Law 2001-323.

[36] During the 2001-2002 Session: S. 104, *see* "Regulate Deferred Deposit;" H. 670, "Reform Payday Lending;" S. 862, "Procedure for Delayed Deposit Checks;" H. 1172, "Revise Law Governing Delayed Deposit of Checks;" H. 1365, "Improve Regulation of Payday Lenders;" H. 1608, "Revise Payday Lending Regulations." During the 2003-2004 Session, *see, e.g.*, H. 1005, "Authorize and Regulate Deferred Deposit Loans." During the 2005-2006 Session, *see, e.g.*, S. 947, "Regulate Deferred Deposit" and three different legislative study bills (H. 1269, H. 413, and H. 1723).

[37] *See supra* text accompanying note 5.

[38] PHS SF No. 3.

[39] PHS SF Nos. 15 - 18.

[40] PHS SF No. 19.

[41] G.S. § 53-281.

[42] PHS SF No. 19.

[43] *Id.*

The documentation required of a customer to obtain an AANC Advance included: (1) identification, (2) a pay stub or other evidence of income, (3) a copy of a recent bank statement. The customer was required to enter into a delayed deposit transaction agreement and repayment agreement with AANC, to write a check to AANC for the amount of the advance plus the applicable fee, and to set a date to return to the AANC location to pay off the delayed deposit transaction and to reclaim the customer's check.[44] AANC employees then entered the customer application information into the Advantage system, a proprietary point of sale system of Parent used in all operating locations of Parent's operating subsidiaries, where it was recorded, transmitted and stored.[45]

In addition to Advantage, AANC received a variety of supervisory and support services from Parent, pursuant to a Management Agreement with Parent, during its operations under the standard business model.[46] AANC also received financing of its operations from Parent in accordance with the Management Agreement.[47] AANC used Parent's proprietary intellectual property through a licensing agreement with AARC.[48]

In addition to services provided by Parent and AARC, AANC contracted, directly or indirectly, with Teletrack, a third party vendor, for services in connection with the making of AANC Advances.[49]

During this period, Center Gross Profit Under Standard Model (CGPSM) for AANC may be expressed, consistent with Parent's financial statements, as follows:

CGPSM = Customer Fees (CF) – Provision for Doubtful Accounts (PDA) – Center Expenses (CE)[50]

As previously stated, it is assumed that the cost of financing from Parent is included in the other subcategory of Center Expenses.

When G.S. § 53-281 expired on August 31, 2001, AANC ceased making Advances for consideration, and, as of September 20, 2001, notified OCOB of its cessation of operations as a check cashing business and its intent to surrender all check cashing licenses for its North Carolina locations.[51]

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[44] PHS SF No. 26.
[45] Prospectus, *supra* note 14, pp. 81-83.
[46] *See supra* text accompanying notes 15-19.
[47] *Id.*
[48] *See* discussion of AARC *supra* notes 20-22.
[49] *See* discussion *supra* text accompanying notes 14-22. Teletrack is a third party service provider who gathers and disseminates to industry subscribers various customer data.
[50] Prospectus, *supra* note 14, F-4.
[51] PHS SF No. 22.

AANC Operates in a Relationship with Peoples National Bank of Paris, Texas: September 11, 2001 to February 28, 2003

After August 31, 2001, AANC entered into a Marketing and Servicing Agreement (the "Peoples Agreement") with Peoples National Bank of Paris, Texas ("PNB") and began to operate its existing cash advance centers under the agency business model.[52] Advances under the Peoples Agreement are hereinafter referred to as "Peoples Advances." In a typical transaction, the customer would write a check for $117, which was made payable to PNB, and receive a PNB check for $100.[53] The effective annual percentage rate for such a transaction, repayable in 14 days, was 443.21%.[54]

The documentation required of a customer to obtain a Peoples Advance included: (1) identification, (2) a pay stub or other evidence of income, and (3) a copy of a recent bank statement. The customer was required to enter into a cash advance and repayment agreement with PNB, to write a check to PNB for the amount of the advance plus the applicable fee, and to set a date to return to the AANC location to pay off the Peoples Advance (which funds would then be deposited into a PNB account) and to reclaim the customer's check.[55]
AANC employees then entered the customer application information into the Advantage system which automatically transmitted the information to Teletrack, as a result of which the transaction was approved or denied.[56]

Under the Peoples Agreement, AANC agreed to, among other things: (i) maintain and staff its cash advance centers, (ii) conduct advertising and marketing for Peoples Advances, (iii) accept and process applications, (iv) distribute the Peoples Advance or a notice of declination to each customer, (iv) hold customer checks when delivered at closing, (v) deposit repayment amounts received from customers, and (vi) provide accounting and collection services.[57] All loan documentation named PNB as the lender.[58]

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[52] PHS SF No. 23.
[53] Letter, dated December 11, 2001, from Monica L. Allie, Senior Vice President of Regulatory and Legal Affairs, Advance America, Cash Advance Centers, Inc., to Philip A. Lehman and L. McNeil Chestnut, North Carolina Department of Justice ("Parent 2001 Letter"), p. 2. The Parent 2001 Letter is referred to an Attachment to the Affidavit of Monica Allie, Respondent's Exhibit 1, ¶ ¶ 11, 12, but is only generally referred to in Respondent's Post Hearing Memorandum ("RPHM"), p. 15. The Parent 2001 Letter is not included in the Exhibits in Support of Respondent's Post-Hearing Memorandum, but it was submitted in the Unindexed Exhibits, and has been marked by the OCOB as UE-1.
[54] PHS SF No. 29.
[55] PHS SF No. 24.
[56] Deposition of Monica L. Allie, August 16, 2005, pp. 28-32, Petitioners' Exhibit 82; Parent 2001 Letter, *supra* note 5, p. 3.
[57] Marketing and Servicing Agreement, dated as of September 11, 2001, between Peoples National Bank and Advance America, Cash Advance Centers of North Carolina, Inc., included in the record of this matter as Petitioners' Exhibit 41, as amended by a Second Amendment to the Marketing and Servicing Agreement, dated February 12, 2002, also included in Petitioners' Exhibit 41 (the "Peoples Agreement").
[58] *Id.*

For its services under the Peoples Agreement, AANC received compensation determined as a percentage of the income generated by the Peoples Advances.[59] The Peoples Agreement further provided that AANC's compensation was to be adjusted by (i) reducing it if losses on "Loans" (as the Peoples Agreement called Peoples Advances) exceeded eight percent of the "finance charges on the Loans," by the amount of such excess; or (ii) increasing it by the amount eight percent of such finance charges exceeded losses.[60] AANC's "Fees" were to be paid twice a month, payable within one day after receipt by PNB of an invoice from AANC.[61] It appears from the invoices from AANC to PNB that AANC was charged for the expense of PNB's Teletrack services (TC).[62]

Gross Center Profit under the Peoples Agreement (GCPPA) may be expressed as follows:

$$\text{GCPPA} = \text{Marketing Processing and Service Fees (MPSF)} - \text{Provision for Agency Bank Losses (PABL)} - \text{CE} - \text{TC}$$

MPSF is comprised of the percentage compensation earned by AANC for services rendered plus the portion of losses assumed by PNB.[63] The AANC compensation percentage varied during the term of the Agreement, but was never less than 81.8667% of Customer Fees, and PNB's portion of losses was 8% of Customer Fees.[64] The PABL was AANC's estimate of the excess of uncollectible accounts over PNB's portion of the losses.[65] In addition, AANC would have received the financial benefit of the assumption of accounts receivable funding costs by PNB.[66]

The difference in operating results for AANC under the Peoples Agreement, as compared to operation under the standard business model, may be expressed as follows:

$$\text{GCPSM} - \text{GCPPA} = [\text{CF} - \text{PDA} - \text{CE}] - [0.8987\ \text{CF} - \text{PABL} - \text{CE}] = 0.1013\ \text{CF} - \text{PDA} + \text{PABL}$$

This comparison is, of course, on an accrual accounting basis. The provision figures, PDA and PABL are estimates,[67] and CF is accrued on a constant yield basis.[68]

As will be seen below, payments to AANC from its bank partners under the bank agency model were computed on a cash basis, not an accrual basis. To convert the comparison of accrual basis operating results to a cash basis, the computation starts with total loan

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[59] Peoples Agreement, *supra* note 57, ¶ 2(g)(i) and Exhibit A.
[60] Peoples Agreement, *supra* note 57, ¶ 2(e)(i).
[61] Peoples Agreement, *supra* note 57, Exhibit A.
[62] Petitioners' Exhibit 42.
[63] Prospectus, *supra* note 14, F-9.
[64] Peoples Agreement, *supra* note 57.
[65] Prospectus, *supra* note 14, pp. F-9, F-10.
[66] There is evidence in the record that AANC or Parent made a loan of $3 million to PNB or its parent as part of this relationship. *See* Petitioners' Exhibit 31, Letter of Counsel for AANC to Commissioner, December 17, 2004, item nos. 2 and 3.
[67] Prospectus, *supra* note 14, pp. F-9, F-10.
[68] *Id.* p. F-9.

fees paid by customers (F) in a given period rather than CF. One must then subtract from F actual losses in such period (L), rather than PDA or PABL. Under this cash method of presentation, Center Cash Profit (CCP) is determined by subtracting from F (or in the case of agency agreements, a percentage of F) losses (L) and Center Expenses (CE). Under this approach, the difference between AANC's Center Cash Profit operating under the standard method (CCPSM) and under the Peoples Agreement (CCPPB) can be stated as follows:

$$CCPSM - CCPPB = [F - L - CE] - [0.8987\ F - L - CE] = 0.1013\ F$$

The foregoing computation shows that AANC gave up approximately 10% percent of gross cash fees to be able to continue to operate in North Carolina. In addition, AANC paid for Teletrack and for the fees of a Texas law firm. Teletrack would probably have been borne by AANC under the standard model; the fees of the Texas law firm, for a relatively small sum, probably not.

The record of this matter includes thirty-five (35) half-monthly AANC Marketing and Servicing Invoices to PNB for periods beginning on September 12, 2001, and ending February 28, 2003.[69] A review of these invoices confirms that:

1. AANC's fee was calculated based on a percentage of the Gross Fees received by PNB for the period in question, subject to various adjustments.

2. A Bad Debt Allocation was stated to be 8% of the Loan Fees Paid stated on the invoice. From this allocation was subtracted actual charge-offs for the period. If the remainder was positive, the charge-offs having been greater than the Bad Debt Allocation, the Amount Due to AANC for such period was reduced by such remainder. If the remainder was negative, with the Bad Debt Allocation exceeding charge-offs, the Amount Due to AANC was increased by such excess.

3. During the 35 periods in question, aggregate fees (F) were $35,528,966. The aggregate "Bad Debt Allocation" for these periods, representing the portion of bad debts borne by PNB was $2,842,317.32, which was 8% of F for such periods. AANC's aggregate base fee for the periods was $29,105,259.23, or 81.92% of F.

4. Aggregate losses (L) for the periods in question were $3,878,503.69, or 10.9% of F. Accordingly, L exceeded the proportion of losses for which PNB was contractually obligated. AANC derived no benefit from PNB's obligation for losses up to

[69] Petitioners' Exhibit 42.

8% of F and in fact absorbed additional losses of $1,036,186.37, or 2.9% of F.

5. Additional charges and adjustments born by AANC for the periods in question aggregated $1,401,739.49, or 3.9% of F. As noted above, most of these expenses would have been borne by AANC under the standard business model.

6. As the result of the foregoing, AANC received aggregate compensation of $26,667,363.37, or 75% of F, for the periods in question.[70]

7. PNB received an aggregate of $3,581,319.82, or 10.08% of F for funding the transactions,[71] and the use of its charter.

The foregoing analysis confirms the mathematical computations that preceded it. AANC continued its cash advance lending business in North Carolina after the State's payday lending law expired by "outsourcing" the funding and underwriting of its operations for a fee of just over 10% of gross revenue.

On March 18, 2002, the Office of the Comptroller ("OCC"), PNB's primary financial regulator, announced the filing of a notice of charges against PNB alleging that PNB had engaged in unsafe and unsound practices in connection with its payday lending program.[72] Among the alleged unsafe and unsound acts were (i) allowing the payday lending program to grow at a rate beyond prudent limits; (ii) inadequate capital; (iii) excessive reliance on "two third-party vendors to market, underwrite, originate, disburse, service and collect payday loans" while failing to assure itself such vendors could perform such services; and (iv) acceptance of "a $3 million loan from the third party that originated all of its payday loans ... [with] a rapidly escalating interest rate [that] ... provides strong incentive for the bank to maintain its payday loan volume at an excessive level to generate earnings to repay the loan."[73]

On January 31, 2003, the OCC announced that Parent and PNB had agreed to end their payday lending relationship and PNB agreed to pay $175,000 in civil money penalties.[74] Under the consent decree issued in connection with this settlement, Parent agreed to end its relationship with PNB in North Carolina and not to enter any contract to become either an agent or bank service provider for a national bank without first applying to the

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[70] Some figures may not foot due to rounding.
[71] *See* Petitioners' Exhibit 31, Letter of Counsel for AANC to Commissioner, December 17, 2004, item nos. 2 and 3 for details on the loan of Parent to PNB.
[72] OCC Press Release, "OCC Files Notice of Charges Against People's National Bank of Paris, Texas," March 18, 2002, *available at* http://www.occ.treas.gov/ftp/release/2002-26.txt.
[73] *Id.* A copy of the Notice of Charges may be viewed at http://www.occ.treas.gov/ftp/release/2002-26a.doc.
[74] OCC News Release, NR 2003-06, dated January 31, 2003, *available at* http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=2BQJOXBC.xml.

OCC.[75] In a press release announcing the settlement, then Comptroller of the Currency John D. Hawke said, "We have been greatly concerned with arrangements in which national banks essentially rent out their charters to third parties who want to evade state and local consumer protection laws ... The preemption privileges of national banks derive from the Constitution and are not a commodity that can be transferred for a fee to nonbank lenders."[76] Copies of the documentation of Parent's entry into this settlement are included in the record of this matter.[77]

In light of its inability to continue to operate under the Peoples Agreement, AANC terminated that agreement, in connection with which it paid PNB or its parent $6,325,000, a portion of which was used to repay the outstanding loan to PNB's parent holding company.[78]

AANC Operates in a Relationship with Republic Bank and Trust Company: February 12, 2003 to July 6, 2005

After entry of the OCC consent decree mentioned above, and effective on or about March 1, 2003, AANC entered a Marketing and Servicing Agreement (the "Republic Agreement") with Republic Bank and Trust Company ("Republic" or "RBT").[79] Republic was a bank organized under the laws of the State of Kentucky and headquartered in Louisville, Kentucky. Republic had the authority to make deferred deposit transactions under Chapter 368 of the Kentucky Revised Statutes.[80] During the period when the Republic Agreement was in effect, Republic did not make Advances in its home state of Kentucky.[81] During that same period, Parent, through another subsidiary, operated not less than thirty locations in Kentucky.[82] Advances under the Republic Agreement are hereinafter referred to as "Republic Advances."

Under Kentucky law, the maximum fee for such a transaction was $15 per $100 of the face amount of each check accepted for deferred deposit.[83] Republic was permitted to assess a fee of $17.50 per $100 advanced on each check accepted for deferred deposit on its North Carolina transactions.[84] In a typical transaction, an AANC customer would write a check for $117.50, which was made payable to RBT and receive $100 check or,

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[75] *Id.*
[76] *Id.*
[77] Petitioners' Exhibit 8.
[78] Prospectus, *supra* note 14, pp. F-18, F-19.
[79] PHS SF No. 32; Marketing and Servicing Agreement, dated as of February 12, 2003, between Republic Bank and Trust Company and Advance America, Cash Advance Centers of North Carolina, Inc. and McKenzie Check Advance of North Carolina, LLC d/b/a National Cash Advance, as amended by First, Second and Third Amendments thereto (the "Republic Agreement), all contained in Petitioners' Exhibit No. 1. Expurgated versions of these documents are also contained in Republic 2004 10-K, Exhibit 10.27. *Available at* http://www.sec.gov/Archives/edgar/data/921557/000110465905011522/a05-1744_110k.htm.
[80] PHS SF No. 35.
[81] PHS SF No. 36.
[82] Prospectus, *supra* note 14, p. 77.
[83] Ky. Rev. Stat. Ann. § 368.100 (2005).
[84] PHS SF No. 35.

after May 3, 2004, funds of Republic on hand at the AANC location.[85] The effective annual percentage rate for such a transaction, repayable in 14 days, was 456.26%, as shown in the Republic truth-in-lending disclosure.[86]

The documentation required of customers to obtain Republic Advances included: (1) identification, (2) a pay stub or other evidence of income, (3) a copy of a recent bank statement and (4) an "Other Transactions" certification, as required by Kentucky law. The customer was required to enter into a deferred deposit transaction agreement and repayment agreement with Republic, to write a check to Republic for the amount of the Advance plus the applicable fee, and to set a date to return to the AANC location to pay off the deferred deposit transaction for deposit into a Republic account and to reclaim the customer's check.[87] AANC employees then entered the customer application information into the Advantage system, which automatically transmitted the information to Teletrack. Teletrack would then on an automated basis apply the credit criteria and credit scoring previously established by the bank and then provide electronic feedback within minutes to the AANC store.[88]

Under the Republic Agreement, AANC agreed to, among other things: (i) maintain and staff its cash advance centers, (ii) conduct advertising and marketing for Republic Advances, (iii) accept and process applications, (iv) distribute the Advance or a notice of declination to each customer, (iv) hold customer checks when delivered at closing, (v) deposit repayment amounts from customers, and (vi) provide accounting and collections services.[89] All loan documentation named Republic as the lender.[90] AANC's performance was guaranteed by Parent.[91]

For its services under the Republic Agreement, AANC received 67% of the revenue (F) generated by the Republic Advances, net of certain expenses.[92] In addition, Republic agreed to assume losses on Republic Advances up to 20% of F in any given period; if losses exceeded 20% of F, Republic reduced its bi-weekly payment to AANC accordingly, and if losses were less than 20% of F, Republic increased its bi-weekly payment to AANC accordingly.[93] AANC was not obligated under the Republic Agreement to pay Teletrack's charges (TC) for services to Republic, which were paid by Republic.[94] In addition, Republic funded outstanding receivables, which reduced Parent's liability to its lenders and, accordingly, AANC's financial liability to Parent, and

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[85] PHS SF No. 28.
[86] PHS SF No. 35.
[87] PHS SF No. 25.
[88] Deposition of Monica L. Allie, *supra* note 56, pp. 28-32. Applications for loans through National Cash Advance (Petitioners' Exhibit 20), PNB (Petitioners' Exhibit 21 and Petitioners' Exhibit 24), and RBT (Petitioners' Exhibit 23), all informed customers of this use of the Teletrack database.
[89] Republic Agreement, *supra* note 79.
[90] Republic Agreement, *supra* note 79, ¶ ¶ 1(gg), 4(a), and 5(a); *see also* Deposition of Leigh Anna Hollis, August 15, 2005, Respondent's Exhibit 18, pp. 34-36.
[91] Joinder and Guaranty Agreement between RB&T, NCA, AANC, and Advance America, dated February 12, 2003, together with amendments. These documents appear as Petitioners' Exhibit 3.
[92] Republic Agreement, *supra* note 79, Exhibit A.
[93] Republic Agreement, *supra* note 79; Otis Meacham Affidavit, Petitioners' Exhibit 39, ¶ ¶ 17, 28.
[94] This is assumed from the absence of a charge on the AANC invoices to RBT.

any relevant interest charges on the liability (LP). In light of the foregoing, cash profit from North Carolina operations under the Republic Agreement (CCPRA) may be stated as follows:

$$CCPRA = 0.87F - L - [CE - TC - LP] = 0.87F - L - CE + TC + LP$$

Invoices calculating the amounts owed under the formula contained in the Republic Agreement were issued at the end of each two-week period of operation and payment was due the day following delivery of such invoices.[95]

The difference in operating results for AANC under the Republic Agreement, as compared to operation under the standard method, may be expressed as follows:

$$\begin{aligned} CCPSM - CCPRA &= [F - L - CE] - [0.87\,F - L - CE + TC + LP] \\ &= 0.13\,F - TC - LP \end{aligned}$$

Assuming a constant level of customer fees and center expenses, the foregoing computation shows that AANC gave up 13 percent of revenue, such amount being reduced by the costs of Teletrack and of receivables financing (each of which was now born by the bank) to be able to continue to operate in North Carolina.

The foregoing calculations are confirmed by the actual operating results under the Republic Agreement. The Petitioners' expert witness reviewed operating invoices under the Republic Agreement for the seventeen month period beginning March 1, 2003, and ending July 31, 2004, and gave evidence that (i) AANC received net fees of $35,603,052.48, or 76.16% of aggregate adjusted Fees for the period; (ii) Republic received net payments of $6,068,633.06, or 12.99% of aggregate adjusted Fees; and (iii) the remaining 10.85% of adjusted gross fees consisted of bad debt losses.[96] Assuming an efficiency ratio of 60%, AANC's estimated take during this period ($14,241,221) is over 2.3 times amounts received by Republic, without accounting for the costs of Teletrack or costs of funding receivables.[97]

During the period of operation under the Republic Agreement, Republic and AANC, as an institution affiliated party of Republic, were subject to supervision and examination by KOFI and FDIC.[98] On March 1, 2005, FDIC issued revised examination guidance on payday lending programs (the "Revised Guidance").[99] The Revised Guidance was issued by FDIC staff in furtherance of the agency's obligation to promote safe and sound operation of banks and was the latest in a series of examiner guidance publications

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[95] Republic Agreement, Exhibit A, Petitioners' Exhibit 1.
[96] Petitioners' Exhibit 39. Affidavit of Otis Meacham ¶ 19 and Exhibit thereto.
[97] The efficiency ratio for North Carolina centers for the nine months ended September 30, 1994, was approximately 60.7%. Prospectus, *supra* note 14, p. 41. Using figures for the same period, raising the efficiency ratio to 65% results in a net return to AANC ($12,461,068) that is still over twice the gross return to Republic.
[98] RPHS, SF No. 44; Republic Agreement, *supra* note 79, Affidavit of Monica L. Allie, *supra* note 56, Attachment ¶ ¶ 20, 74-76, and 91-99.
[99] FDIC FIL-14-2005, "Guidelines for Payday Lending," Respondent's Exhibit 50.

regarding subprime lending generally and payday lending in particular.[100] Its stated purpose was to describe "safety and soundness and compliance considerations for examining and supervising state nonmember institutions that have payday lending programs."[101] Requirements of financial institutions under the Revised Guidance included the following:

1. Establish appropriate "cooling off" or waiting periods between the time a payday loan is repaid and another application is made;

2. Establish the maximum number of loans per customer that are allowed within one calendar year or other designated time period; and

3. Provide that no more than one payday loan is outstanding with the bank at a time to any one borrower.

4. Ensure that payday loans are not provided to customers who had payday loans outstanding **at any lender** for a total of three months during the previous 12 months. When calculating the three-month period, institutions should consider the customers' total use of payday loans at all lenders.[102]

As a result of the change in FDIC guidance, AANC and Parent terminated the Republic Agreement.[103] In announcing this action, Parent's statement included the following:

> On March 2, 2005, the FDIC issued revised Payday Lending Guidance ...that limits the frequency of borrower usage of payday cash advances and limits the period a customer may have payday cash advances outstanding from any lender to an aggregate of three months during the previous 12 month period ... On July 5, 2005, and effective July 6, 2005, we terminated our marketing and servicing agreement with Republic and entered into a new marketing and servicing agreement (the "First Fidelity Agreement") with First Fidelity Bank, a South Dakota bank ... to operate as a marketing, processing, and servicing agent for payday cash advances and installment loans made by First Fidelity in our 117 payday cash advance centers in North Carolina.[104]

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[100] *Id.* p. 1 and footnote 1 therein.
[101] *Id.* p. 1.
[102] *Id.* p. 9.
[103] Current report on Form 8-K of Advance America, Cash Advance Centers, Inc, dated on July 6, 2005, (the "Parent July 2005 8-K"), p. 2, included in the record of this matter as Respondent's Exhibit 79 and as Commissioner's Exhibit 4. *Available at* http://www.sec.gov/Archives/edgar/data/1299704/000110465905031764/a05-11992_18k.htm.
[104] *Id.*

While the foregoing statement appears to link the issuance of the revised payday guidance to the termination of the Republic Agreement, it does not do so in so many words. In fact, the foregoing disclosure does not state any basis for such termination. A review of the Republic Agreement makes this circumstance clearer, for it shows that there was not any basis in the agreement for termination at all, much less in the preemptory manner noted above.

Section 8 of the Republic Agreement is entitled "Term and Termination." Its provisions may be summarized as follows:

1. Paragraph (a) of Section 8 provides that the term of the agreement shall be three years from the effective date of the agreement.[105] As February 12, 2003 is the effective date of the Republic Agreement, this paragraph is clearly inapplicable.

2. Paragraph (b) of Section 8 provides that if the State of North Carolina enacts legislation *satisfactory to AANC* regarding the making of Advances, then AANC *upon 30 days notice* is authorized to (i) require Republic to continue making Advances under the Agreement, subject to a requirement to assure receipt of a stipulated amount; or (ii) terminate the agreement and enter into a replacement agreement with Republic in another state; or (iii) make Advances in its own name and pay Republic a stipulated amount through the term of the Republic Agreement.[106] This paragraph is revealing of the nature of the relationship of AANC and Republic, but is not a ground for immediate termination in the circumstances described above.

3. Paragraph (c) of Section 8 provides for the payment of a stipulated sum upon the termination of the Republic Agreement without cause by Republic.[107] This paragraph is inapplicable to the facts surrounding the termination by AANC.

4. Paragraph (d) of Section 8 allows termination by AANC six months after (i) the commission of a material breach of the Republic Agreement by Republic or (ii) the filing by Republic under state or federal liquidation, receivership or conservatorship statutes or (iii) the bankruptcy of AANC.[108] There was no ground for termination under this paragraph.

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[105] Republic Agreement, *supra* note 79, ¶ 8(a). It should be noted that this paragraph and paragraphs of Section 8 subsequently quoted are disclosed in an expurgated version of the Republic Agreement which appears as Exhibit 10.27 to Republic 10-K, Year End December 31, 2004, which Form 10-K is included in this record as Commissioner's Exhibit 7.

[106] Republic Agreement, *supra* note 79, ¶ 8(b).

[107] *Id.* ¶ 8(c).

[108] *Id.* ¶ 8(d)(i), (ii), (iii).

5. Paragraph (e) of Section 8 allows AANC to terminate the agreement on 30 days written notice if (i) Republic ceases to fund Advances, (ii) any amendment to the Kentucky law authorizing the Republic Advances or other applicable law has an adverse effect on AANC, or (iii) Republic amends its policies and procedures in a way that is materially adverse to AANC. This paragraph is inapplicable to the facts surrounding the termination.

6. Paragraph (h) of Section 8 authorizes termination *on 30 days written notice* if (i) an act of God or other natural disaster makes performance impossible, (ii) "if a party's performance hereunder is rendered illegal or materially adversely affected by reason of changes in law or regulations (either federal or state) applicable to the [Republic Advances] or to either party hereto."[109] Although it may be argued that the amended FDIC guidance on payday lending is a materially adverse regulation, such argument would be incorrect for a number of reasons, to wit: (a) it is not a "rule or regulation" as that phrase is used in the Federal Deposit Insurance Act[110] and (b) the guidance does not materially and adversely affect Republic's ability to make Republic Advances, only the amount and timing of such Advances, as to which there is no requirement in the Republic Agreement. The effect of the amended FDIC guidance is more specifically addressed in paragraph (i) of Section 8.

7. Paragraph (i) of Section 8 allows termination by a party that has been advised in writing by a regulatory agency having jurisdiction of such party or the Republic Advances "that the performance of that party's obligations under this Agreement is or may be unlawful or *constitutes or may constitute an unsafe or unsound banking practice or that such activity may jeopardize such party's standing with or applicable rating from such regulatory agency,* then the party ...who has been so advised ... may terminate this Agreement *by giving written notice at least six (6) months in advance of termination to the other party...*"[111] The amended FDIC Guidance clearly did provide that the frequency and certain other aspects of the Republic Advances could constitute unsafe or unsound banking practice *by Republic*, which was the party to the Republic Agreement to whom the guidance was directed. Accordingly, *Republic* rather than AANC had the option under

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[109] *Id.* ¶ 8(h).

[110] As noted above, the Revised Guidance is just that: guidance to examiners. It is not an agency rule interpreting the FDI Act or any other law. The status of an attempt by the FDIC to issue rules with respect to interstate operation of banks generally is discussed at notes 258-263 *infra*.

[111] Republic Agreement, *supra* note 79, ¶ 8(i) (emphasis added).

> Paragraph 8(i) to terminate the Republic Agreement, and then only upon six months written notice.

AANC had no ground to peremptorily terminate the Republic Agreement as a result of the Revised Guidance. This conclusion was shared by Republic. In response to a July 5, 2005, letter from AANC purporting to terminate the Republic Agreement on July 6,[112] the General Counsel of Republic responded with a letter that included the following statements:

> your letter does not specify under what provision of Section 8 you are proceeding. Additionally, we have no record of any notice of termination from you prior to July 5, 2005 ... nor any recent conversations whereby we agreed to terminate ... Republic specifically reserves all rights available to it pursuant to the North Carolina M&S Agreement dated February 12, 2003.[113]

Republic's parent holding company subsequently publicly disclosed that the Republic Agreement had been terminated by Parent and that it would commence the offering of payday loans directly through its Indiana bank subsidiary.[114]

AANC Operates in a Relationship with First Fidelity Bank: July 6, 2005 to September 15, 2005

FFB's relationship with AANC began in 2001 when the bank was contacted by AANC or Parent.[115] After the termination of AANC's relationship with RBT, on or about July 6, 2005, AANC entered into a Marketing, Processing and Servicing Agreement (the "FFB Agreement") with First Fidelity Bank of Burke, South Dakota ("FFB").[116]

FFB is a state non-member bank organized under the laws of South Dakota and, accordingly is subject to regulation by the FDIC and South Dakota Division of Banking ("SDDB").[117] At June 30, 2005, FFB had total assets of $204,390,000, equity capital of

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[112] Letter, dated July 5, 2005, from S. Sterling Laney III, Vice President, Counsel and Chief Compliance Officer of Parent, to Mike Beckwith and Michael Ringswald of Republic, included in the record of this matter as Petitioners' Exhibit 76.

[113] Letter, dated July 6, 2005, from Michael A. Ringswald, General Counsel of Republic to Sterling Laney and John T. Egeland of Parent and Robert M. Buell, Esq., included in the record of this matter as Petitioners' Exhibit 77.

[114] Report on Form 8-K of Republic Bancorp, Inc., dated July 5, 2005, included in the record of this matter as Commissioner's Exhibit 12. *Available at* http://www.sec.gov/Archives/edgar/data/921557/000110465905031950/a05-12073_18k.htm.

[115] Deposition of George Kenzy, President and Chief Executive Officer of FFB, Respondent's Exhibit 19, p. 10.

[116] Affidavit of George Kenzy, dated August 2, 2005, Respondent's Exhibit 7, Attachment ¶ 4; Marketing, Processing and Servicing Agreement, dated as of July 6, by and between First Fidelity Bank and AANC, (the "FFB Agreement") included in the record of this matter as Petitioners' Exhibit 45.

[117] Affidavit of George Kenzy, Attachment ¶ ¶ 39, 42 as Respondent's Exhibit 7.

$29,777,000 and net income of $3,103,000.[118] At that same date, Parent had total assets of $400,444,000, total stockholders' equity of $307,613,000 and net income of $30,483,000.[119] Of FFB's total loan portfolio of $90.6 million, farmland and agricultural loans accounted for approximately $53 million, other loans secured by real estate for approximately $17 million, other commercial and industrial loans for $10.4 million and "other consumer loans" for $8.6 million.[120] In his deposition, FFB's President estimated the amount of FFB Advances to be $6 million and $4.5 million and the amount of Installment Loans to be $5.5 million.[121] In order to comply with FDIC capital guidelines, FFB participated 37% of its North Carolina consumer loans to a Washington bank and 20% of such loans to two individual FFB insiders.[122]

AANC's change of banks was the result of the Revised Guidance and, in particular, the restrictions that such guidance put on the number of payday advances that could be made to a customer in a year while allowing other alternative long-term credit products, generally installment loans.[123]

To achieve optimal compliance with the Revised Guidance, Parent rearranged its contractual relations in agency states by: (i) amending its agreement with a South Dakota bank other than FFB in Pennsylvania to include consumer installment loans; (ii) terminating its agreement with a Washington state-chartered bank in Arkansas and entering an agreement with FFB regarding operations in that state; and (iii) replacing Republic with FFB in North Carolina.[124] In addition, Parent caused an agreement with FFB in Michigan to be terminated and began offering cash advance services to customers in that state directly in a manner similar to the standard method.[125] Parent's disclosure of these changes went on to state that "we expect that we will retain 60 - 80% of *our revenue*" in agency states but that it expected the share of overall revenue represented by the three states just mentioned to drop from 14% of total revenue to 10% (a reduction of 29%).[126]

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[118] Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income in Respect of FFB for the period ended June 30, 2005 (the "FFB June 2005 ROC"), included in the record of this matter as Petitioners' Exhibit 89, Schedules RC and RI.

[119] Quarterly Report on Form 10-Q of Parent, for the quarter ended June 30, 2005, appears in this record as Commissioner's Exhibit 5 and Respondent's Exhibit 80. *Available at* http://www.sec.gov/Archives/edgar/data/1299704/000110465905039695/a05-13162_110q.htm.

[120] FFB June 2005 ROC, *supra* note 118, Schedule RC-C.

[121] Deposition of George Kenzy, *supra* note 115, pp. 9, 49.

[122] *Id.* pp. 56-58.

[123] Parent Form 10-Q for the quarter ended June 30, 2005, Respondent's Exhibit 80, Commissioner's Exhibit 5, p. 25.

[124] *Id.* p. 26.

[125] *Id.* p. 28.

[126] *Id.* pp. 26-27 (emphasis added).

FFB was authorized to make both FFB Advances and high interest rate installment loans under South Dakota law.[127] Notwithstanding its authority to do so, FFB did not make Advances in South Dakota.[128] During 2002, 2003 and 2004, Parent, through a subsidiary, operated between eight and ten locations in South Dakota.[129] FFB did not make Advances in any states other than Michigan, North Carolina and Arkansas.[130]

Republic was not authorized under Kentucky law to make high interest rate installment loans comparable to the FFB installment loans at the rates charged by FFB under South Dakota law and, accordingly was replaced by Parent in North Carolina.[131] FFB was removed from Michigan, where Parent could offer advances directly, such loss being replaced by funding of loans in Arkansas and North Carolina.

Under the FFB Agreement, AANC agreed to provide marketing, processing and collection services similar to those provided under the Republic Agreement.[132] As in the Republic agreements, documentation named FFB as the lender and FFB Advances were funded by FFB checks or cash from funds of FFB held by AANC on behalf of FFB.[133]

Operations under the FFB Agreement differed from the prior agency arrangements in North Carolina in several respects. FFB Advances were made for a fee of $20 per $100 advanced, resulting in an APR of 521.43% for a 14 day advance.[134] In addition, North Carolina customers were also offered consumer installment loans ("Installment Loans") that were, as the name implies, repayable in twice monthly installments over a loan term that did not exceed four months, for a fee of between $55 and $65 per $100 lent.[135] The one example of an Installment Loan analyzed by Petitioners' expert witness had an APR of over 300%, and FFB concedes that the interest on such loans exceeds the rates permitted by North Carolina law.[136] In order to obtain a FFB Advance or Installment Loan, the customer was required to provide the AANC location with a customer information work sheet, pay stub, bank statement, blank check and two forms of identification.[137] Customer information regarding FFB Advances or Installment Loans was then sent to Teletrack, for review and approval or denial in accordance with standards established by FFB; including debt to income analysis in the case of

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[127] Affidavit of Kenzy, *supra* note 116, Attachment ¶ 52, referring to SDCL 54-3-1.1 (this reference applies only to the statements in the paragraph as to South Dakota Law).
[128] Deposition of Kenzy, *supra* note 115, p. 17.
[129] Prospectus, *supra* note 14, p. 78.
[130] Deposition of Kenzy, *supra* note 115, p. 15.
[131] Deposition of Monica Allie, *supra* note 56, pp. 23, 24.
[132] Supplemental Affidavit of Otis Meacham, Petitioners' Exhibit 86, ¶ 9.
[133] Affidavit of Kenzy, *supra* note 116, attachment ¶ ¶ 28, 29; Deposition of Kenzy, *supra* note 115, pp. 44-46.
[134] Kenzy Deposition, *supra* note 115, pp. 41, 43-44; Petitioners' Exhibit 55 [TILA chart] and Respondent's Exhibit 72.
[135] Kenzy Deposition, *supra* note 115, pp. 42, 43; *see also* Petitioners' Exhibit 54 and Respondent's Exhibit 73.
[136] Otis Meacham Supplemental Affidavit, *supra* note 132, ¶ 7; Kenzy Affidavit, *supra* note 116, Attachment ¶ 52.
[137] Deposition of Kenzy, *supra* note 115, pp. 28-32 and Exhibits 2 and 3 thereto.

Installment Loans.[138] If the loan was approved, the customer was required to execute and deliver loan documents and a personal check for the loan amount plus the applicable fee and, in return, received a FFB check or cash of FFB in the possession of AANC.[139]

AANC's compensation under the FFB Agreement was as follows:

> (i) for FFB Advances (A) a Marketing and Processing fee of $40 per closed loan and (B) a Servicing and Collection Fee of 71% of fees collected minus the Marketing and Processing Fee; and (ii) for Installment Loans (A) a Marketing and Processing Fee of $200 per closed loan, payable on a per installment basis and (B) a Servicing and Collection Fee equal to 71% of fees collected minus the Marketing and Servicing Fee.[140]

Settlement under the FFB Agreement was to be made by ACH transfer on the date immediately following "settlement," which in this case would be delivery of an AANC invoice.[141]

Evidence about the actual results of operation under the FFB Agreement is sparse, given the short period of time under which such operations were conducted. Assuming for the purposes of this analysis that AANC's portion of Fees (which for this purpose includes interest on Installment Loans) is 71%, center cash profit from North Carolina operations under the FFB Agreement (CCPFFB) may be expressed as follows:

$$CCPFFB = 0.71F - CE + TC + LP$$

The difference between cash profit under the standard method and under the FFB Agreement may be expressed as follows:

$$\begin{aligned} CCPSM - CCPFFB &= [F - L - CE] - [0.71F - CE + TC + LP] \\ &= 0.29F - L - TC - LP \end{aligned}$$

As shown above, under the FFB Agreement, AANC gives up 29% of gross fees in exchange for a release from all responsibilities for losses, Teletrack costs and the cost of funding receivables. On a gross basis AANC's share of F (71%) is 2.4 times the share of FFB. Petitioners' expert witness compared the financial results of operations under the Republic Agreement with those under the FFB Agreement. He found that under the RB&T agreement, RBT was paid $2.25 for each $100 loan, and that RB&T was required to set aside $3.50 (20% of each $17.50 loan fee). He also found that FFB received $5.80 for each $100 in loans, but was required to bear the loss of unpaid loans. The difference of $3.55 between the two banks is almost identical to the $3.50 RB&T was required to set

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[138] *Id.* pp. 23-27.
[139] *Id.* pp. 27, 36.
[140] FFB Agreement, *supra* note 116, Exhibit A.
[141] *Id.* ¶ 8.

aside for bad loans. In other words, when the risk of bad loans shifted to the bank, so did almost the precise amount of fees needed to cover any bad loans.[142]

While a comparison of net returns to AANC and FFB is difficult to make since figures are not available from AANC's relationship with FFB, it is not unreasonable to assume that at a 60% efficiency ratio, AANC's CCPFFB would be 28.4 % of F; and, assuming L under the FFB Agreement continued at the rate of prior agency arrangements in North Carolina (10.8% of F) and other operating expenses of FFB were only 0.2%, then FFB's net return would be 18% of F. Accordingly, AANC's CCPFFB would be approximately 1.6 times that of FFB. At a 65% efficiency ratio, AANC's net would be 1.4 times that of FFB.

On September 14, 2005, Parent announced that FFB was temporarily suspending its payday cash advance and installment loan originations as of the close of business on September 15, 2005.[143]

Statements and Actions of Governmental Agencies and Officials

The Commissioner of Banks is charged by statute with interpreting and administering the CFA. Official interpretations of the statute by the Commissioner may take the form of declaratory rulings under G.S. § 150B-4. The Attorney General of North Carolina has a statutory duty under G.S. § 114-2(5)"to give, when required, his opinion upon all questions of law submitted to him by the General Assembly, or by either branch thereof, or by the Governor, Auditor, Treasurer, or any other State officer." Attorney General opinions are advisory and do not have the force of law.[144]

Statements and Actions Relating to the Interpretation of § 53-281

While G.S. § 53-281 was still in force, the Commissioner, responding to a request, issued a declaratory ruling on November 30, 1998, with respect to the practices of certain check cashers, especially with respect to deferred deposit check cashing transactions. The Respondent participated in the process that led to that declaratory ruling.[145] Beginning in 1999, the Office of the Commissioner of Banks, with the assistance and support of the payday lending industry, promulgated and adopted regulations relating to Article 22 of Chapter 53,[146] which became effective July 1, 2000.

The only other official pronouncements having to do with payday lending under G.S. § 53-281 which followed from the Office of the Commissioner of Banks were (i) a notice dated July 24, 2001, to the effect that the legislature had postponed the sunset date of that provision in an effort to consider applicable legislation that would re-authorize and

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[142] Supplemental Affidavit of Otis Meacham, *supra* note 132, ¶ 8.
[143] *See supra* text accompanying note 5.
[144] *Lawrence v. Shaw*, 210 N.C. 352, 361 (1936) *rvs'd on other grounds, Lawrence v. Shaw*, 300 U.S. 245 (1937).
[145] See Declaratory Ruling dated November 30, 1998, ¶ 1.
[146] Title 4 N.C. Admin. Code Subchapter 3L "Check-Cashing Businesses," Sections .0101 *et seq.*

reform the regulation of payday lending;[147] and (ii) a similar notice, dated August 30, 2001, informing check-cashing licensees that G.S. § 53-281 would expire on August 31, 2001 and that consequently, "there is no lawful basis for 'payday lending' without such a law, *including 'payday lending' transactions effected by 'agents' or 'facilitators' of out-of-state institutions.*"[148]

There is no evidence in the record to indicate that after the sunset date of G.S. § 53-281 on August 31, 2001, a declaratory ruling was sought by AANC, Parent or any other person engaged in the business of lending with regard to Advances nor is there any evidence of anyone seeking a declaratory ruling that such activity was permitted by North Carolina law. Further, there is no evidence that an opinion of the North Carolina Attorney General was sought with regard to such issue by any private party or by the Commissioner.

Statements and Actions Relating to the Legislative Debate on a Successor to G.S. § 53-281.

During the course of the 2001-2002 Session of General Assembly, no fewer than six different bills were introduced having to do with the regulation of payday lending in one way or another, not counting the measure which postponed the sunset.[149] This pattern of interest and debate and activity on the part of the public and members of the legislature continued for subsequent sessions of the legislature,[150] with no one measure ever finding enough support to win approval by both houses. The sunset, as a consequence, continues in place.

As a condition imposed when the North Carolina General Assembly enacted G.S. 53-281, the Commissioner of Banks was instructed to report to the 2001 General Assembly on the practices of licensees with regard to checks cashed pursuant to the provisions of this section, including any evidence as to consumer complaints, unfair or deceptive trade practices, and the frequency of repeat use by individuals of postdated or delayed deposit checks.[151] This official, written report was made and delivered to the legislature by then Commissioner of Banks Hal D. Lingerfelt on or about February 22, 2001.[152]

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[147] Petitioners' Exhibit 78. Commissioner's Exhibit 17.

[148] Petitioners' Exhibit 79. Commissioner's Exhibit 19. (Emphasis added). The **"URGENT MEMO"** went on to state, "...licensees should **make no further payday loans after August 31, 2001**, ...either directly or as agent for another, since they are without legal authority to enter such transactions." (Emphasis in the original).

[149] 2001-2002 Session: S. 104, "Regulate Deferred Deposit"; H. 670, "Reform Payday Lending"; S. 862, "Procedure for Delayed Deposit Checks"; H. 1172, "Revise Law Governing Delayed Deposit of Checks"; H. 1365 "Improve Regulation of Payday Lenders"; H. 1608, "Revise Payday Lending Regulations."

[150] During the 2003-2004 Session, *see, e.g.*, H. 1005, "Authorize and Regulate Deferred Deposit Loans." During the 2005-2006 Session, *see, e.g.*, S. 947, "Regulate Deferred Deposits," and three different "study bills," H. 1269, H. 413, and H. 1723.

[151] Session Laws 1997-391, s. 2.

[152] This document is available online at: http://www.nccob.org/NR/rdonlyres/2A95D7DA-75C0-49F3-B896-CAC45D947727/0/CheckCashersReporttoGenAssembly.pdf.

North Carolina Attorney General Roy Cooper took an interest in the legislative debate on payday lending.[153] Before G.S. § 53-281 expired, he issued a statement urging the General Assembly to "close the out-of-state bank loophole," by which payday loans were being made in North Carolina "without any regulation."[154] A similar statement was issued by Joshua Stein, Senior Deputy Attorney General on August 22, 2001.[155] Commissioner of Banks Hal Lingerfelt corresponded with Attorney General Cooper during the on-going debate, and on May 8, 2002, he shared with him a draft of a proposal, requested by the North Carolina Speaker of the House, for a new bill that, among other things, would "end unregulated, bank-affiliated payday lending."[156]

Statements and Actions in Enforcing the CFA against Payday Lenders After the Sunset of G.S. § 53-281

Before the enactment of G.S. § 53-281, payday lending was subject to the CFA and to N.C. usury law.[157] G.S. § 53-281 carved out a temporary exception to the CFA on behalf of payday lenders. When § 53-281 expired, so did the authorization for payday lenders, and payday lending then became subject again to the CFA and N.C. usury law.[158] Accordingly, in a notice dated August 30, 2001, the Commissioner of Banks informed all persons who were thought to be engaged in payday lending that the authorizing statute had expired and that there was no longer any legal authority for such activity in North Carolina.[159] William Webster IV, CEO of Advance America, has given evidence that, on November 27, 2001, he heard comments at a meeting with some members of the OAG which gave him the "impression that the government had concluded that [AANC's activities in North Carolina were] legal, albeit unregulated, under North Carolina law."[160]

The Attorney General and the Commissioner of Banks filed an action in Wake County Superior Court on January 14, 2002, seeking to enjoin Ace Cash Express, which was purportedly acting as the agent of Goleta National Bank, from "offering, arranging, and making usurious consumer loans known as 'payday loans.'"[161]

On August 26, 2004, the Commissioner of Banks officially notified Mr. Webster that the payday lending activities of Advance America were being investigated. In contrast, Mr. Webster has given evidence that, as late as December 2004, he *knew*, through discussions with unspecified "government representatives" that OCOB believed it "lacked jurisdiction over [consumer] complaints" about AANC's activities in North Carolina.[162] Attorney General Roy Cooper allegedly informed Mr. Webster at an unspecified time, "in

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[153] *See, e.g.*, Statement from Attorney General Roy Cooper, July 11, 2001, House Financial Institutions Committee, found in the record at Respondent's Exhibit 27.
[154] *Id.*
[155] Respondent's Exhibit 30.
[156] Respondent's Exhibit 34.
[157] *See supra* text accompanying note 30.
[158] *Id.*
[159] *Id.*
[160] Affidavit of William M. Webster, IV, June 23, 2005, Respondent's Exhibit 13, Aff. ¶ 3.
[161] *State v. Ace Cash Express*, No. 020 CvS 00330 (Wake Co. Superior Ct., N.C., Jan. 14, 2002).
[162] Affidavit of Webster, *supra* note 160, Aff. ¶ 6.

words or substance," that AANC's activities were "unregulated in North Carolina," and that the State "lacked jurisdiction" over the activities of AANC, and therefore AANC "could proceed lawfully in the State."[163]

On December 8, 2004, Charlie Fields, an examiner employed by the OCOB, responded to a consumer complaining about AANC's business practices by informing her that the OCOB had "no jurisdiction in this matter" and referring her to the South Dakota Division of Banking.[164] The obvious purpose of this letter was merely practical: to direct a consumer to a possible source of a timely resolution of a consumer complaint about a bank in South Dakota, and not to express a legal opinion about a controversial subject.

Summary: Findings of Material Facts

The record in this proceeding is extensive and, accordingly, I have set forth below a summary of the factual inferences and conclusions, supported by the clear weight of the evidence, upon which I have based the legal analysis and conclusions that follow in this Order. The following summary does not, of course, foreclose my use of other facts found above in such legal analysis and conclusions.

AANC is an operating extension of Parent and cannot be viewed in isolation from the overall operations of Parent.

AANC is an operating subsidiary through which Parent conducts its business in North Carolina. All issues regarding operating policies and procedures other than minor ministerial functions at the store level are determined by the Parent. Supervision, oversight and executive management are provided by the Parent. It is telling to note that none of the affidavits included in Respondent's evidence are from officers or employees of AANC. All are from officers of Parent or expert witnesses not affiliated with AANC or Parent.

Parent operates a multi-state financial services business engaged in the making, processing and servicing of loans in different formats dependent upon the laws of the states in which it operates. AANC is one of its operating arms in the conduct of such business.

AANC's operating arrangements with banks were established and altered by Parent in order to maximize Parent's financial return from such operations based on federal and state laws at any particularly time pertaining.

When permitted by North Carolina law, AANC operated under the standard business model, making loans in its own name.

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[163] *Id.* at ¶ 9.
[164] Respondent's Exhibit 44.

When the North Carolina law permitting direct Advances expired, Parent and AANC entered a contractual arrangement with a national bank, seeking to obtain the benefit of federal preemption of state usury and consumer protection laws and thus to avoid the proscriptions of North Carolina law. To achieve this result, Parent lent the national bank or its parent holding company $3 million to enhance the capital of the bank.

When the OCC ordered Parent, AANC and the national bank to cease operations, and the Comptroller of the Currency declared such activity to be an impermissible "charter rental" by the bank, Parent sought and found another charter to rent, this time the charter of a state chartered bank supervised by the Commonwealth of Kentucky and the FDIC. Through this arrangement, Parent sought to continue its avoidance of North Carolina usury and consumer protection laws by claiming federal preemption under the interest exportation provisions of the Federal Deposit Insurance Act (the "FDI Act").[165]

When the FDIC revised its supervisory guidance on payday advance lending in a way that reduced the volume of transactions that could be generated by AANC in accordance with Kentucky law, Parent peremptorily terminated AANC's contractual relationship with the Kentucky bank. Parent then had AANC enter into a marketing and servicing arrangement with a bank from South Dakota, a state whose laws permitted high interest rate lending of a kind that would allow Parent, acting through AANC, to continue is operation under the purported protection of federal law and to maximize transaction volume through AANC centers.

AANC was not the agent in any meaningful sense of the banks with which it entered marketing, processing and servicing agreements; rather the banks provided funding for Parent's operations in North Carolina through AANC.

At the outset, it must be noted that AANC has shown by a preponderance of the evidence that in its operating arrangements under the bank agency model the bank for which AANC purports to be an agent has (i) been the lender on the notes executed by customers at AANC locations; (ii) reviewed and approved operating policies and procedures; and (iii) established or agreed to underwriting criteria that were applied by AANC, Parent and Teletrack in a way that allowed the automated system of loan origination operated by Parent to generate loans with a level of risk agreed to by the bank. Funding of the Advances and, in the case of FFB, Installment Loans, is more problematic. As mentioned above, Parent provided $3 million of funding for PNB, and 57% of the funding by FFB is from participations, 20% of FFB's portfolio funding coming from two bank insiders.

Parent's activities, through subsidiaries under both the standard and agency business models, are wholly or partially funded by banks.[166] The difference in the various modes of operation is the cost of such funding. When AANC operated under the standard business model, its receivables were financed by Parent under the Management

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[165] 12 U.S.C. § 1811 *et seq.*

[166] *See* Prospectus, *supra* note 14, p. F-3, which included the balance sheet of Parent at September 30, 2004, in which outstanding amounts on a revolving credit facility comprise approximately 43% of total assets, 55% of total liabilities and 200% of total stockholders equity.

Agreement with intercorporate advances that bore interest at 90% of NationsBank prime, a reflection of the cost to Parent of financing such inventory. In addition to the interest cost of bank financing to Parent, Parent also bore the cost of compliance with the terms and conditions of bank loan agreements. As the analysis above shows, the change from the standard business model to the agency business model in North Carolina kept the basic cost structure of AANC in place. What changed was the cost of financing its receivables, which reflected (i) the cost of use of the bank's charter and (ii) the extent to which the bank's financing of receivables had or did not have stop loss protection from AANC. In even the most costly of its marketing and servicing arrangements, which occurred when AANC contracted with FFB, AANC's operating return was 40% to 60% greater than that of FFB, without taking into full consideration the financing and related costs avoided by that relationship.

AANC's and Parent's control of the relationship with the agency banks is further evidenced by procedures used by AANC. The customer interface and application process was virtually identical, whether AANC was operating on its own or as a purported agent of the banks with which it related.

Additionally, the amounts, means and methods of the payments AANC received under the various bank agreements show AANC's control of the relationships. AANC received more than 80% of the gross fees in its relationship with PNB, and more than 70% of the gross fees in its relationships with RB&T and FFB. The payments to AANC were calculated with reference only to the amount of fees generated in its centers, were billed bi-weekly, and were paid virtually immediately by the bank upon receipt of AANC's invoice. The suggestion that AANC's compensation was received from the general funds of the bank, as if dollars received from fees are somehow different from dollars in the banks' accounts, is risible.

The analysis above makes clear that Parent and AANC had a clear and continuing operating control of, and a predominant economic interest in, the relationships with each of the banks for which AANC was the purported agent, and that Parent changed such relationships aggressively, and in the case of Republic unlawfully, when such change suited the purposes of Parent, operating through AANC.

AANC's Marketing and Servicing Relationship with FFB Confers Material Economic Benefit on Two Individuals

As noted above,[167] a substantial portion of FFB's Advances (and perhaps Installment Loans) were participated to a bank chartered by the State of Washington and to two individuals who were described by the President of FFB as "insiders."[168] The "insiders" held aggregate participations equal to 20% of the North Carolina portfolio. Given the size of the bank and the probable control status of the "insiders," I infer that a material portion of the economic benefit derived by FFB through its relationship with AANC was conferred on two persons in a position to control the conduct of FFB's business. In its

[167] *See* discussion *supra* text accompanying note 122.
[168] Deposition of Kenzy, *supra* note 115. *See* discussion *supra* text accompanying note 122.

arrangements with FFB, AANC operated as the purported agent not only of a bank but of two individuals who, although associated with a bank, were acting in their individual capacities.

AANC has produced no direct official statement from either the Attorney General or the Commissioner to it after the sunset date of the North Carolina payday lending law either authorizing AANC's activities or taking a no-action position with respect to its activities.

None of the statements of public officials upon which AANC purports to have relied has been shown to be worthy of reliance by AANC or Parent and none has been shown to be binding on me in deciding this matter. Further, none of such statements was an official interpretive statements to AANC authorizing or approving its conduct of business operations in North Carolina after the expiration of G.S. § 53-281 or taking a no-action position with respect to such operations. There is no evidence in the record that AANC or Parent sought such an official interpretation, even though the record clearly establishes that they knew that such official guidance was available and how to ask for it.

II. LEGAL ANALYSIS AND CONCLUSIONS

The North Carolina Consumer Finance Act

Summary of the CFA

The North Carolina Consumer Finance Act[169] is a consumer protection statute that prohibits the contracting for, exaction or receipt of excessive compensation in connection with the making of small consumer loans and provides for a system of licensing of the makers of such loans at rates otherwise prohibited by the North Carolina usury law, Chapter 24 of the General Statues of North Carolina ("Chapter 24").

The provision of the CFA defining its scope, G.S. § 53-166(a), reads as follows:

> No person shall engage in the business of lending in amounts of ten thousand dollars ($10,000) or less and contract for, exact, or receive, directly or indirectly, on or in connection with any such loan, any charges whether for interest, compensation, consideration, or expense, or any other purpose whatsoever, which in the aggregate are greater than permitted by Chapter 24, except as provided in and authorized by this Article, and without first having obtained a license from the Commissioner. The word "lending" as used in this section, shall include, but shall not be limited to, endorsing or otherwise securing loans or contracts for the repayment of loans.[170]

[169] Session Law 1961-1053. Codified as Article 15, Chapter 53, North Carolina General Statutes. N.C. Gen. Stat. §§ 53-164--191.
[170] G.S. § 53-166 (a).

This provision goes on to include within the statute's prohibitions avoidance by "any device, subterfuge or pretense whatsoever"[171] and establishes penalties for noncompliance.[172] The term "person" includes "any person, firm, partnership, association, or corporation."[173] The "amount of the loan" is defined to include "the aggregate of the cash advance and the charges authorized under the CFA.[174]

The CFA provides for a system of licensure and supervision of persons who make loans covered by the statute.[175] It further provides for limitations on fees and charges and other normative restrictions on the conduct of licensees in the making of such loans.[176]

The CFA confers on the State Banking Commission and the Commissioner rulemaking power under the statute.[177] The statute confers on the Commissioner the power to conduct investigations, hold hearings, issue cease and desist orders, seek injunctive relief in the courts, and make criminal referrals.[178]

The CFA exempts from its coverage "any person, firm or corporation doing business under the authority of any law of this State or the United States relating to banks" or other institutions and agencies or certain other enumerated activities.[179] It also contains a provision dealing with the application of the statute to out-of-state lenders and their agents.[180]

North Carolina's usury law provides that consumer loans such as Advances and Installment Loans may not exceed sixteen percent (16%) per annum unless they are made by a licensed lender under the CFA.[181] The CFA prohibits the making of loans of $10,000 or less with rates and charges in excess of this statutory maximum *except* as provided in the CFA *and* only then if the person engaged in the business of making such loans is licensed by the Commissioner.[182] The statute allows for the making of installment loans *by licensees* of $3,000 or less at rates not exceeding 36% per annum on the first $600 and 15% per annum on any balance in excess of that amount.[183] The CFA also permits installment loans *by licensees* of $10,000 or less at rates not exceeding (i) 30% per annum of the unpaid balance not exceeding $1,000 and 18% for the rest of the principal, if the loan is not exceeding $7,500; and (ii) a straight 18% per annum on the outstanding balance, if the loan is over $7,500.[184]

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[171] G.S. § 53-166(b).
[172] G.S. § 53-166(c),(d).
[173] G.S. § 53-165 (j).
[174] G.S. § 53-165(a), (c); G.S. § 53-173; G.S. § 53-176.
[175] G.S. §§ 53-167 -- 53-172.
[176] G.S. §§ 53-173 -- 53-184; 53-189.
[177] G.S. § 53-185.
[178] G.S. §§ 53-186, 53-187.
[179] G.S. § 53-191.
[180] G.S. § 53-190.
[181] G.S. § 24-1.1.
[182] G.S. § 53-166(a).
[183] G.S. § 53-173. This provision contains other conditions and limitations on such loans not here relevant.
[184] G.S. § 53-176. This provision contains other conditions and limitations not here relevant.

Issues to Be Determined

The CFA confers upon the Commissioner of Banks the following powers:

1. To issue subpoenas, conduct hearings and transcribe testimony in making the investigations and conducting the hearings provided for herein or in the other exercise of his duties, and to give such publicity to the investigation as he may deem best for the public interest.[185]

2. When the Commissioner has "reasonable cause to believe that any person is violating or threatening to violate any provisions" of the CFA, the Commissioner is authorized to issue an order to "desist or to refrain from such violation" and to pursue other equitable remedies.[186]

The CFA also makes violation of its provisions a Class 1 misdemeanor and requires the Commissioner to refer such violations to the appropriate district attorney.[187] The statute also provides for further penalties for violations, including voiding of loan contracts.[188]

In a Pre-Hearing Order, dated April 21, 2005, the Commissioner ruled that the central issue in contest in this proceeding is "whether AANC's operations violate the Consumer Finance Act" and that the sole remedy in respect of a violation or violations, if found, would be issuance of an order to cease and desist.[189] After the issuance of the April 21, 2005 Pre-Hearing Order, AANC terminated the Republic Agreement and entered the FFB Agreement.[190] For purposes of this proceeding, the "current operations" of AANC means its operations from the commencement of this proceeding, February 1, 2005, until suspension of operations on or about September 15, 2005. This period includes operations under the Republic Agreement and the FFB Agreement. Factual findings above relating to prior periods are relevant for purposes of this Order as they show that operations during the period from and after February 1, 2005, are part of a continuing course of conduct by Parent and AANC.

In order to determine whether a cease and desist order should issue, the Commissioner must determine three separate but related issues: (i) whether AANC is subject to the CFA at all, and, if so, whether it has violated that statute; (ii) whether AANC is exempt from the application of the CFA, either under the terms of the statute or otherwise; and (iii) whether the Commissioner or his office is estopped to enforce the CFA against AANC.

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[185] G.S. § 53-186.
[186] G.S. § 53-187.
[187] G.S. § 53-166(c).
[188] G.S. § 53-166(d).
[189] April 21, 2005 Pre Hearing Order, findings ¶ 10; findings ¶ 8-9, order ¶ 2.
[190] Parent July 2005 8-K, *supra* note 103, p. 2.

Is AANC Subject to the CFA?

In order to establish that AANC is subject to the CFA, it must be determined that AANC is (i) a person that is (ii) engaged in the business of lending, (iii) which lending is in amounts of $10,000 or less. We consider these elements in order.

Is AANC a "person" under the CFA?

As to this first element, there is no dispute. AANC is a Delaware corporation and, accordingly, it is a "person" under the CFA.[191]

Is AANC "engaged in the business of lending" under the CFA?

There is substantial dispute about whether AANC is "engaged in the business of lending" as that phrase is used in the CFA.

The Attorney General argues that the CFA should be interpreted liberally and that under such interpretation AANC is so engaged because the entire purpose of all of its activities is in furtherance of the business of lending.[192] Intervenors similarly argue that the legislative and regulatory history of the CFA supports a broad interpretation of that statute in the interest of consumer protection and that AANC's conduct involves the business of lending.[193]

AANC advances four arguments against application of the CFA to its activities under the bank agency model:

1. The plain language of G.S. § 53-166(a) does not apply to AANC's business activities under the agency business model.[194]
2. The legislative history of the CFA supports AANC's argument that the statute does not apply to it.[195]
3. The CFA should be interpreted strictly in AANC's favor because it is criminal in nature.[196]
4. General principles of usury militate against the application of G.S. § 53-166(a) to AANC.[197]

AANC makes an additional argument that the law of agency "dictates" against a finding of liability under the CFA.[198] Resolution of the issues enumerated above also resolves the issues raised by this argument from the law of agency.

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[191] G.S. § 53-165(j). PHS SF No. 1.
[192] Petitioners' Brief, pp. 22-39.
[193] Intervenors' Brief, pp. 24-35.
[194] Respondent's Brief, pp. 39, 43-47.
[195] Respondent's Brief, pp. 40, 47 – 52.
[196] Respondent's Brief, pp. 40, 53.
[197] Respondent's Brief, pp 40, 53-56.
[198] Respondent's Brief, pp. 40, 56-60.

All parties agree that the interpretation of the phrase "engaged in the business of lending" under the CFA is a matter of first impression. There is no reported case, rule, declaratory ruling or other official statement of any governmental person or entity that specifically interprets the phrase.

Given this lack of authority, the meaning of this phrase must be determined by reference to (i) the literal language of G.S. 166(a), (ii) the language and structure of the CFA generally and (iii) the legislative history of the statute.[199] On the basis of such a review, I have determined that AANC is "engaged in business of lending" as that term is used in CFA.

G.S. § 53-166(a) is intended to effect two legislative purposes: (i) to prohibit the contracting for, exaction or receipt of compensation in connection with small consumer loans that exceed the limits set by Chapter 24 and the CFA; and (ii) to require licensing of and regulatory compliance by persons who make loans under G.S. §§ 53-173 and 53-176 at the rates of interest and with the attendant charges permitted by those provisions of the statutes. The CFA may be violated by a person who contravenes either of those legislative purposes or both of them.

As to the first of these purposes, the statute is very expansive, defining its scope as follows:

> *No person* shall engage in the business of lending in amounts of ten thousand dollars ($10,000) or less *and* contract for, exact or *receive, directly or indirectly*, on *or in connection with* any such loan, *any charges* whether for interest, *compensation, consideration, or expense, or any other purpose whatsoever* which *in the aggregate* are greater than permitted by Chapter 24...[200]

This is very broad language indeed, and a review of the plain language of the rest of the CFA makes clear the intention of the General Assembly that this statement of the statute's scope be interpreted and applied broadly. Subsection (b) of G.S. § 53-166 states that subsection (a) applies to "*any person* who seeks to avoid its application by *any* device subterfuge or pretense *whatsoever*."[201] G.S. § 53-166(b) reinforces the clear intention of the General Assembly that the broad language of subparagraph (a) is to be read and applied broadly.

The breadth of language in G.S. § 53-166 is in sharp contrast to the language employed regarding the second of the two legislative policies of the CFA: licensing and regulation of small lenders who wish to obtain exemption from the application of Chapter 24 by obtaining a license and complying with the provisions of the CFA.[202] G.S. § 53-173, one

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[199] Intervenor's Brief, pp. 24-25, "Principles of Statutory Construction," and cases cited therein.
[200] G.S. § 53-166(a) (emphasis added).
[201] G.S. § 53-166(b) (emphasis added).
[202] G.S. § 53-166 (a) goes on to provide that its prohibitions shall apply "except as provided in and authorized by this Article, and without first having obtained a license."

of the two provisions implementing this exception authorizes such lending in the following terms:

> Every *licensee* under this section may *make loans* in installments not exceeding three thousand dollars ($3,000) in amount, at *interest rates* not exceeding [statement of rate limitations]...[203]

This section of the CFA goes on to describe applicable rates and charges for such loans in significant detail.[204] In the same way, G.S. § 53-176, the second of the two exceptional lending authorizations, begins as follows:

> In lieu of making loans in the amount and at the interest stated in G.S. 53-173 and for the terms stated in G.S. 53-180, a *licensee* may at any time elect to *make loans* in installments not exceeding ten thousand dollars ($10,000) and which shall not be repayable in less than six months or more than 84 months and which shall not be secured by deeds of trust or mortgages and which are repayable in substantially equal consecutive monthly payments [the section goes on to a statement of rate limitations]...[205]

Here again, this provision goes on to define the conditions and limitations relating to such loans in detail.[206] G. S. § 53-180, which is referred to in the provision just cited, states that:

> Except as otherwise provided in this Article, no *licensee making a loan* pursuant to G.S. 53-173 shall *enter into any contract of loan* under this Article providing for any scheduled repayment of principal more than [a series of limitations follows]...[207]

This section also contains a detailed list of conditions regarding the making of loans.[208] G.S. § 53-172, which deals with "other business" of licensees, begins as follows:

> No licensee shall conduct *the business of making loans* under this Article within any office, suite, room, or place of business in which any other business is solicited or transacted.[209]

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[203] G.S. § 53-173(a) (emphasis added); *see* rate limitations discussion *supra* note 183.
[204] G.S. § 53-173.
[205] G.S. § 53-176 (a) (emphasis added); *see* rate limitations discussion *supra* note 184.
[206] G.S. § 53-176.
[207] G.S. § 53-180(a) (emphasis added).
[208] G.S. § 53-180.
[209] G.S. § 53-172 (emphasis added).

The foregoing recitation makes clear that when the General Assembly wished to refer in the CFA to the making of loans, it knew how to do so clearly and distinctly. Such references are to "licensees" under G.S. § 53-173 or G.S. § 53-176.[210] The use in the very first substantive clause on the CFA of the phrase "engage in the business of lending" accordingly refers to something different and broader than "licensees," and the phrase includes the activities of persons engaged in such business but not directly making loans--persons such as AANC.

This interpretation is supported by the legislative history of the CFA. In AANC's recounting of the legislative history of the CFA, it argues that the statute is derived from:

1. A 1945 consumer loan law that defined "loan agencies or brokers" by reference to a relevant privilege license tax statute, to include, "persons or concerns...commonly known as loan companies or finance companies...and those persons, firms, or corporations pursuing the business of lending money... "[211]

2. The North Carolina Small Loans Act, enacted in 1955, rewrote the 1945 law, expanding its protection of borrowers, but retaining its definition of "loan agencies or brokers."[212]

AANC goes on to point out that the CFA does not define "lender" or "lending," claims that the jurisdictional basis of the statute is the same as prior law, and argues that a broader interpretation of the reach of the statute leads to anomalous results under G.S. §§ 53-172, 53-173, 53-175, 53-176, 53-179, 53-180, 53-181, and 53-182. AANC does not discuss the reason for the breadth of G.S. § 53-166(a) or (b).

AANC's reading of the CFA in light of prior law might be persuasive if (i) Section 165 defined "lender" and "loans" in language similar to prior law; (ii) Subsection 166(a) said that the CFA applied to every person engaged in the business of "making loans or lending money" and deleted the broad additional language about forms of compensation included in the scope of the statute and language regarding direct or indirect receipt of such compensation, the need for which language is obviated by the explicit requirements of the supervisory provisions mentioned above; and finally, if (iii) Subsection 166(b) were deleted from the statute. Unfortunately for AANC's argument, none of this is so. Rather, the statute is intentionally broader than prior law and is intended to reach beyond the limits which AANC's argument seeks to impose.

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[210] This same interpretation applies to the other provisions of the CFA cited by AANC in its brief, i.e., G.S. §§ 53-175, 53-179, 53-181 and 53-182.

[211] Respondent's Brief, p. 47 (quoting G.S. § 105-88(b) (1950)).

[212] Respondent's Brief, p. 47 (referencing G.S. § 53-164 *et seq.* (Public Laws 1955, c. 1279)). A 1957 amendment replaced the reference to the privilege tax statute and defined "lender" as "...any person, firm or corporation engaged in the business of making loans, lending money, or accepting fees for endorsing or otherwise securing loans or contracts for repayment of debts." (1957, c. 1429, s. 1). Much of this broadened 1957 language is still in the CFA; *see* G.S. § 53-191.

The scope of the CFA is broad because its creation and enactment were intended to address abuses not adequately addressed by prior law. According to Mr. Edwin Gill, North Carolina's Treasurer at the time of the approval of the CFA by the Banking Commission for submission to the General Assembly:

> some time ago there were complaints about the way in which the small loan law was being administered and there were talk of abuses and at one time the Attorney General made some very forceful statements about the matter ... And time and again, complaints were made that the enforcement of the law was not good enough and it would often turn out that the reason the Banking Commissioner could not enforce the law better was because the law itself was far from perfect. In other words, it was susceptible to what had been termed abuses.
>
> When we went into it we found that some of the so-called abuses were actually permitted by the present law ... the things that were being done which had in some way shocked the conscience of the State apparently were legal under the present law.[213]

While much of the discussion of the proposed statute by Mr. Gill deals with stricter regulation of small loan companies, the policy driving the preparation and enactment of the statute was clear: to prevent abusive lending that technically complied with the law. Section 166 of the CFA was broadly drafted to that end.

It is clear that amounts received by AANC in connection with Advances and Installment Loans under the bank agency model of operation, if covered by the CFA, have vastly exceeded the amounts established by either Chapter 24 or the CFA. Accordingly, receipt of such amounts would violate the CFA. AANC argues that an interpretation subjecting AANC to the CFA is inconsistent with Chapter 24. AANC submits that the CFA was "written over the general backdrop of a general North Carolina usury statute ... The statutes, then, must be considered in *pari materia*."[214] AANC argues that Chapter 24 applies to "lenders;" that AANC is not a lender contemplated by Chapter 24, but a third party agent or broker; that applicable authority requires that the two statutes be harmonized or reconciled; and that the treatment of AANC as a lender makes such reconciliation impossible and is inconsistent with decisions under Chapter 24.[215]

AANC's argument regarding the relationship of the CFA and Chapter 24 is neither correct nor persuasive. The two statutes are consistent and require little or no harmonization or reconciliation. The CFA refers to Chapter 24 but does not incorporate its definitions or its substantive provisions, including remedies. If AANC is found to be subject to the CFA and to have received compensation greater than the amount determined with reference to Chapter 24 or the CFA, it will be made subject to a cease

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[213] Transcript of a Special Called Meeting of the North Carolina Banking Commission, December 7, 1960; Intervenors' Exhibit 19, p. 1; quoted in Intervenors' Brief, pp. 7-8.
[214] Respondent's Brief, p. 53.
[215] *Id.* pp. 53-56.

and desist order. There is no inconsistency in the two statutes. The CFA extends to persons and conduct that are not covered by Chapter 24 in a way that does no damage to that statute whatsoever.

Finally, AANC argues that the CFA must be interpreted strictly in its favor because the statute is a criminal statute.[216] This argument does not prevail for two reasons. First, the legislative history and plain language make clear that the CFA is a remedial statute enacted to protect the public and that as such it should be interpreted liberally to give effect to the clear intentions of the General Assembly.[217] Second, this is not a criminal proceeding; rather, it is a civil proceeding where the relief sought, if granted, will be prospective and injunctive under the April 21, 2005 Pre-Hearing Order in this matter.

It is clear from the record in this matter that during the period from the February 1, 2005 through suspension of business on September 15, 2005, AANC was "engaged in the business of lending" in North Carolina for purposes of the CFA. In particular, at all times during such period:

1. AANC was the wholly-owned and controlled subsidiary of a company (Parent) whose sole purpose was and is to engage in the business of lending.

2. The sole purpose of AANC's centers in North Carolina, both before and during the period in question, was the origination, processing and servicing of loans. Accordingly, such centers were operated solely in furtherance of the business of lending.

3. AANC, as operating arm of Parent, conducted its operations in a manner intended to maximize the financial return from its business operations in the centers, which returns were directly related to volume of lending business in such centers. When Republic was unable, due to legal constraints, to generate volumes sufficient to meet the volume goals of AANC and Parent, it was summarily replaced with a bank that could make loans of a kind sufficient to meet such goals.

4. AANC, as Parent's operating arm, was clearly the controlling entity in its relationships with Republic and FFB. AANC's financial returns from its operations were substantially greater than those of the banks in question, on both a gross and net basis. Further, Parent altered its bank partners from state to state as its needs dictated and as various laws changed. The banks provided (i) a banking rationale on the basis of which AANC and Parent could assert state law exemption and (ii) financing of receivables.

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[216] *Id.* p. 53

[217] *See generally* Petitioners' Brief, pp. 26-38 and particularly, p. 36 and cases cited there; also, Intervenor's Brief, pp. 2-9, and pp. 24-25 and cases cited there.

> These bank services were in furtherance of the conduct of the business of lending by AANC and Parent rather than the conduct of AANC being in the furtherance of the business of banking.

These findings are supported by the additional findings above that AANC's operations during the period in question were part of a consistent course of conduct that began at the sunset of G.S. § 53-281.

Are AANC's Advances and Installment Loans covered by the CFA?

The CFA covers the business of lending in amounts of $10,000 or less.[218] The statute defines the "amount of the loan" to mean "the aggregate of the cash advance and the charges authorized by G.S. 53-173 and G.S. 53-176."[219] "Cash advance" is defined as "the amount of cash or its equivalent that the borrower actually receives..."[220]

It is clear from the foregoing that Advances and Installment Loans are covered by the CFA. Advances and Installment Loans are loans in which the borrower receives cash or its equivalent (a bank check) in an amount less than ten thousand dollars.

Finding

As a result of the foregoing analysis, I find that AANC is, and at all times relevant to this proceeding has been, a person engaged in the business of lending in amounts of ten thousand dollars or less as those terms are used in the CFA and, accordingly, AANC is subject to the CFA.

Has AANC Violated the CFA?

It is a violation of the CFA for a person engaged in the business of lending in amounts of ten thousand dollars or less to:

> contract for, exact, or receive, directly or indirectly, on or in connection with such loan, any charges whether for interest, compensation, consideration, or expense, or any other purpose whatsoever" amounts greater than that permitted by Chapter 24.[221]

As noted above, the quoted provision goes on to permit the charges higher than those permitted by Chapter 24 to licensees; however, AANC is not a licensee. Accordingly, the issue to be decided here is whether AANC received compensation in amounts greater than permitted by Chapter 24 and, as a result, in violation of the CFA.

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[218] G.S. § 53-166(a).
[219] G.S. § 53-165(a).
[220] G.S. § 53-165(c).
[221] G.S. § 53-166(a).

AANC Received Compensation in Excess of the Amounts allowed by the CFA

It is clear from the record that during the period in question, AANC contracted for and received, in connection with loans covered by the CFA, indirect compensation which in the aggregate was greater than permitted by Chapter 24 or the CFA.

Following the sunset of G.S. § 53-281, AANC surrendered its check cashing license and opened a relationship with Peoples National Bank.[222] Peoples Advances bore interest at a rate of 443.21%.[223] Under the Peoples Agreement, AANC never received less than 81.8667% of Customer Fees, adjusted for small expenses and losses.[224] Actual cash flow receipts of AANC in this record[225] show that, in accordance with the Peoples Agreement, AANC received fees in amounts (0.82 X 443% = 365.28%) which exceeded the amounts allowed under Chapter 24 or the CFA.

Republic Advances bore interest at the rate of 456%.[226] Under the Republic Agreement, AANC received base compensation of 67% of fees generated by Republic Advances of adjustments for certain immaterial expenses and losses.[227] Analysis of the actual flow of payments under the Republic Agreement show that the actual receipts by AANC were on average 76% of fees generated by Advances.[228] Accordingly, AANC's base charges, calculated as APR of such advances, were approximately 303% (0.67 X 456%) and approximately 347% after adjustments (0.76 X 456%). These payments are vastly greater than the amounts permitted by Chapter 24 or the CFA.

FFB Advances bore interest at the rate of 521% and Installment Loans bore interest at higher rates than that.[229] The First Fidelity Agreement provided that AANC was to receive compensation based on flat fees and a percentage of the total fees generated by First Fidelity Advances.[230]

As more fully discussed above,[231] it is reasonable to assume that AANC charged and received payments under the FFB Agreement in an amount not less than 71% of the fees and interest generated by FFB Advances and Installment Loans. Assuming an APR of 521% on such Advances and Installment Loans, AANC's portion represents an APR of

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[222] *See* discussion *supra* text accompanying notes 51-52. PHS SF Nos. 15, 21-23.
[223] A fee schedule for Peoples Advances does not appear in this record, *but see* PHS SF No. 23 and SF No. 29.
[224] Marketing and Servicing Agreement with Peoples National Bank dated September 11, 2001, together with First and Second Amendments thereto ("Peoples Agreement"), appear in this record as Petitioners' Exhibit 41.
[225] Invoices from AANC to Peoples National Bank for the period September 12, 2001 to February 28, 2003, appear in this record as Petitioners' Exhibit 42.
[226] *See supra* text accompanying note 86; PHS SF No. 35.
[227] Republic Agreement, *supra* note 79, Exhibit A.
[228] Invoices from AANC to Republic Bank & Trust for the period August 1, 2004, to May 31, 2005, appear in this record as Petitioners' Exhibit 43.
[229] For Advances, *see* fee schedule at Petitioners' Exhibit 51; for Installment Loan, *see* sample agreement at Petitioners' Exhibit 54.
[230] FFB Agreement, *supra* note 116, Exhibit A.
[231] *See supra* text accompanying notes 140-142.

approximately 370%. Assuming an APR of 300% for Installment Loans, AANC's share would amount to an APR of 213%. These payments are vastly greater than the amounts permitted by Chapter 24 or the CFA.

AANC argues that it did not violate the CFA because, among other things, it did not directly receive any portion of the amounts paid by the borrowers of Peoples Advances, Republic Advances, FFB Advances or FFB Installment Loans.[232] This argument is incorrect as a matter of law. G.S. § 53-166(a) clearly states that it covers amounts "indirectly" received by a person engaged in the business of lending. In the case at hand, AANC received, earlier from Peoples and later from both Republic and from First Fidelity, amounts equal to either (i) a fixed sum per loan or (ii) a percentage of the fees and interest received on Advances and Installment Loans. Such sums were to be paid by the relevant bank virtually immediately after receipt of an invoice from AANC. The payments received by AANC under the Peoples Agreement, Republic Agreement, and First Fidelity Agreement were clearly indirect payments of amounts in respect of the relevant loans and far exceeded the limits of Chapter 24 or the CFA.

Findings

On the basis of the foregoing, I find that AANC contracted for, exacted and received, indirectly, in connection with the Peoples Advance, Republic Advances, FFB Advances and FFB Installment Loans, charges that in each case in the aggregate were greater than permitted by Chapter 24 or the CFA.

As I have found previously that AANC is a person engaged in the business of lending and that the Republic Advances, First Fidelity Advances and First Fidelity Installment Loans are all loans subject to the CFA, I further find that at all times during its current operations under the Republic Agreement and First Fidelity Agreement, AANC was in violation of the CFA.

Is AANC Exempt from the CFA?

Notwithstanding the determination above that AANC has violated the normative provisions of the CFA, it remains to be determined whether AANC is exempt from the CFA by the terms that statute or otherwise. This determination involves the further interpretation of the CFA itself and consideration of whether enforcement of the statute is preempted by federal law.[233] In this regard, AANC argues that it is exempt under G.S. § 53-190 or G.S. § 53-191.[234] It further argues that enforcement of the CFA against it is preempted by federal law and, accordingly, the United States Constitution.[235]

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[232] *See, e.g.*, Respondent's Brief, p 52.
[233] The issue of possible federal preemption of the CFA on the basis of Peoples National Bank's status as a federally-chartered bank is not before me and consequently will not be considered.
[234] Respondent's Brief, pp. 39, 41-43.
[235] Respondent's Brief, pp. 64-79.

Is AANC Exempt under G.S. § 53- 190?

G.S. § 53-190 reads as follows:

> (a) No loan contract made outside this State in the amount or of the value of ten thousand dollars ($10,000) or less, for which greater consideration or charges than are authorized by G.S. 53-173 and 53-176 of this Article have been charged, contracted for, or received, shall be enforced in this State. Provided, the foregoing shall not apply to loan contracts in which all contractual activities, including solicitation, discussion, negotiation, offer, acceptance, signing of documents, and delivery and receipt of funds, occur entirely outside North Carolina.
>
> (b) If any lender or agent of a lender who makes loan contracts outside this State in the amount or of the value of ten thousand dollars ($10,000) or less, comes into this State to solicit or otherwise conduct activities in regard to such loan contracts, then such lender shall be subject to the requirements of this Article.
>
> (c) No lender licensed to do business under this Article may collect, or cause to be collected, any loan made by a lender in another state to a borrower, who was a legal resident of North Carolina at the time the loan was made. The purchase of a loan account shall not alter this prohibition.[236]

AANC argues that because G.S. § 53-190(b) refers to agents of out-of-state lenders but does not state that such agents are liable under the CFA, such agents are therefore exempt from the statute.[237] This argument misreads the CFA generally and G.S. § 53-190 in particular.

G.S. § 53-190 is clearly intended to define the extent to which the CFA extends to lenders, not otherwise exempt from the statute, that operate outside the borders of the State of North Carolina. Subsection (a) makes clear that loans that would be subject to the CFA if made in the State of North Carolina are only enforceable by out-of-state lenders if all of the material aspects of the loan transaction occur outside North Carolina. Subsection (b) makes clear that an out-of-state lender is subject to the CFA if either the lender or its agent comes into the state to solicit loans or otherwise conduct lending activity. Subsection (c) makes clear that out-of-state lenders cannot use lenders licensed under the CFA to collect non-compliant loans as agent or through sale of the loans to the licensees.

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[236] G.S. § 53-190.
[237] Respondent's Brief, pp. 41, 42.

Read in context, subsection (b) of G.S. § 53-190 is a long-arm statute intended to extend the State's jurisdiction to out-of-state lenders when they operate in North Carolina, either directly or through agents. The reason this provision is silent as to agents is that agents are not the target of the provision. In the case of an agent of an out-of-state lender the issue of jurisdiction does not apply to the agent, which is operating in North Carolina and as a result is clearly subject to the State's jurisdiction. Rather, the issue is whether the CFA applies to the lender. G.S. § 53-190(b) clearly deals with this issue alone. There is nothing in the language of this provision that even remotely suggests that the General Assembly intended G.S. § 53-190 to amend or repeal G.S. § 53-166 directly or by implication.

Is AANC Exempt under G.S. § 53-191 or Principles of Federal Preemption?

G.S. § 53-191 reads as follows:

> Nothing in this Article shall be construed to apply to any person, firm or corporation doing business under the authority of any law of this State or of the United States relating to banks, trust companies, savings and loan associations, cooperative credit unions, agricultural credit corporations or associations organized under the laws of North Carolina, production credit associations organized under the act of Congress known as the Farm Credit Act of 1933, pawnbrokers lending or advancing money on specific articles of personal property, industrial banks, the business of negotiating loans on real estate as defined in G.S. 105-41, nor to installment paper dealers as defined in G.S. 105-83 other than persons, firms and corporations engaged in the business of accepting fees for endorsing or otherwise securing loans or contracts for the repayment of loans.[238]

The operative language for purposes of this matter is "a person, firm or corporation doing business under the authority of any law ... of the United States relating to banks."[239] G.S. § 53-191 would apply to either Republic or FFB if (i) either of those institutions were a party to this proceeding; and (ii) there were a federal statute under the authority of which they were doing business. As neither bank is a party, the issue to be determined is whether AANC is operating under the authority of federal law as a result of its relationship with either of the banks.

AANC makes a separate but related argument that enforcement of the CFA against it is preempted under federal law and the United States Constitution.[240] This argument is based in the concept of "conflicts preemption," under which a state cannot enforce a law that conflicts with or frustrates the purposes of federal law.[241] Here, AANC argues that enforcement of the CFA against it would frustrate the interstate operations of the banks provided for by the FDI Act.

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[238] G.S. § 53-191.
[239] *Id.*
[240] Respondent's Brief, pp. 42, 43.
[241] *See id.*, pp. 64-65, 69-71.

The federal statute on which AANC bases its claim for exemption or preemption is Section 27 of the Federal Deposit Insurance Act, 12 U.S.C. 1831d ("Section 27"), which reads, in pertinent part, as follows:

> In order to prevent discrimination against State-chartered insured depository institutions ... with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank ... would be permitted to charge in the absence of this subsection, such State bank ... may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any other note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 percentum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank ... is located or at the rate allowed by the laws of the State ... where the bank is located...[242]

AANC argues that the Republic and FFB Advances and the FFB Installment Loans were made by banks located in states where the fees and charges in respect of such instruments were legal, that such lending activity was undertaken in reliance on Section 27 and settled principals of federal preemption.[243] AANC further argues that the nature of its relationship with the banks was of such a nature that forbidding it to continue would frustrate the banks' lending programs and federal policy and, as a result, is preempted by federal law and the United States Constitution. These arguments do not withstand scrutiny.

State law is not lightly set aside, especially in areas typically regulated by state law, like banking[244] and consumer protection,[245] unless Congress has shown a clear intent to preempt the state law, either by express language, by clear implication,[246] or by a federal agency acting within the authority given to it by Congress.[247]

The express language of Section 27 refers to the protection of banks with regard to interest rates charged by banks in states other than their home states. The authority of Republic or FFB to charge the rates reviewed above on Advances and Installment Loans is not at issue in this matter. If it were, Republic and FFB would be the proper parties to raise such issue. Neither bank is a party to this matter and neither has raised this issue in collateral proceedings or any other way.

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[242] 12 U.S.C. § 1831d(a).
[243] Respondent's Brief, pp. 64-66.
[244] *See, e.g., Munn v. Illinois*, 94 U.S. 113 (1876) (Field, J. dissenting) (noting that usury law is a traditional area of state regulation); *Abilene Nat'l Bank v. Dolley*, 228 U.S. 1 (1913) (denying national bank's motion to enjoin the Kansas Commissioner of Banks from enforcing state law).
[245] *General Motors Corp. v. Abrams*, 897 F.2d 34, 41-42 (1990).
[246] *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Cipollone v. Liggett Group*, 505 U.S. 504, 518 (1992).
[247] *New York v. FERC*, 535 U.S. 1, 18 (2002).

AANC then seeks to find direct authority for the preemption argument on its behalf and has difficulties. Its opening sentence on the applicability of conflict preemption to this case states that:

> Although Section 27(a) contains express preemption language, courts have reached mixed results on whether it forecloses the application of state law.[248]

AANC's brief then cites two cases: one that preempts the assertion of state usury claims against state chartered banks,[249] clearly not directly apposite here; and the second, *Bankwest, Inc. v. Baker*,[250] where the 11th Circuit Court of Appeals upheld a Georgia law outlawing payday lending in that state. AANC cites *Bankwest* at 1345 to acknowledge that the FDI Act cannot support preemption of state law under the doctrine of field preemption.[251] It goes on to argue that the CFA is preempted on a "conflicts preemption" theory and bases that argument on *Cline v. Hawke*,[252] an unpublished case involving an OCC interpretation of the Gramm-Leach-Bliley Act to preempt a state law governing insurance sales.[253] AANC cites no federal case wherein a court has found any congressional intent which supports AANC's interpretation of Section 27.

AANC goes on to argue that it should gain the benefit of federal preemption under Section 27 because the banks were the true lenders of Advances and Installment Loans and AANC was only their agent, providing ministerial services in connection with such advances and loans.[254] This argument is not supported by the facts in this matter. As fully set forth above, the facts do not support the characterization of AANC as a mere agent. AANC and Parent were the controlling parties in all such relationships, took the predominant share of the benefits of such relationships, and changed partners virtually at will to insure the maximum return to Parent. Further, even if AANC's argument regarding agency is accepted for this purpose, the language it quotes from the legislative history of Section 27 supports the banks' ability to export rates, which is not at issue here.

AANC argues by implication, though not expressly, that a federal agency acting within the authority given to it by Congress has preempted the CFA. AANC argues that federal regulators and home state bank regulators have authority to supervise and regulate third party providers without establishing that such authority creates a preemptive right on behalf of either the agent bank or AANC.[255] AANC's brief reviews in detail the provisions of the Bank Service Company Act but does not point to any preemptive provisions in that statute or to any cases applicable to this matter. The one case cited by

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[248] Respondent's Brief, p. 69.
[249] *Hill v. Chemical Bank*, 799 F. Supp. 948, 952 (D. Minn. 1992), cited in Respondent's Brief, p. 69.
[250] *Bankwest, Inc. v. Baker*, 411 F. 3d 1289 (11th Cir. 2005).
[251] Respondent's Brief, p. 71.
[252] 51 Fed. Appx. 392, 2002 U.S. App. LEXIS 23831, 2002 WL 31557392 at *4, (4th Cir. Nov. 19, 2002), cert. denied, 540 U.S. 813 (2003).
[253] Respondent's Brief p. 71.
[254] Respondent's Brief, pp 66-69.
[255] Respondent's Brief, pp. 72-76.

AANC involves conflict between two federal agencies regarding enforcement of federal law.[256] This is interesting, but inapposite.

AANC argues that the FDIC's March 31, 2005 Revised Guidance to examiners is evidence that the FDIC "has expressly acknowledged the legitimacy of third-party relationships and issued specific guidance to institutions regarding management of such relationships."[257] What AANC does not say is that the Revised Guidance is not an interpretation of the FDI Act, including particularly Section 27, or the United States Constitution. As its name implies, the Revised Guidance is examiner guidance issued as part of the agency's overall program of bank supervision. It is the latest in a series of such documents relating to the involvement of insured depository institutions in subprime lending. While I have the greatest respect for the FDIC, I do not view the Revised Guidance as binding or particularly instructive with regard to statutory and constitutional interpretation. Statutory extension of FDIC enforcement to third parties, and the Examiner Guidance which implements the statute for practical use is meant to protect depositors and cannot possibly be stretched to defeat the CFA, which is meant to protect borrowers from abuse.

Of greater relevance to this matter is an ongoing proceeding of the FDIC that AANC has not seen fit to mention: the agency's rulemaking proceedings with regard to the preemption of state law under Sections 24(j) and 27 of the FDI Act.[258] These proceedings began with the publication by the FDIC of a "Petition for Rulemaking to Preempt Certain State Laws," submitted to the agency by the Financial Services Roundtable, a financial services industry trade group.[259] The petition requested that the FDIC act to address alleged imbalances in the interstate operations of federal and state-chartered banks. The Financial Services Roundtable requested, among other things, that the FDIC (i) define the scope and application of Section 104(d) of the Gramm-Leach-Bliley Act ("GLBA") regarding preemption of state laws that impose a requirement, limitation or burden on a depository institution *or its affiliate (emphasis added)* and (ii) promulgate regulations to implement Section 27.[260] Based on the language in GLBA § 104(d), the petition urged the FDIC to define circumstances under which state laws would be preempted.[261] By contrast, the petition requested that implementation of Section 27 make the exportation of interest rates under that statutory provision comparable to the rights of national banks under Section 85 of the National Bank Act.[262]

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[256] Federal Trade Commission, In the Matter of Dillard Department Stores, Inc., quoted in Respondent's Brief at p. 74.
[257] Respondent's Brief, p. 76
[258] Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking, Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60,019 (October 14, 2005).
[259] Federal Deposit Insurance Corporation, Petition for Rulemaking to Preempt Certain State Laws, 70 Fed. Reg. 13,413 (March 21, 2005).
[260] *Id.* pp. 13,416, 13,418, 13,425.
[261] *Id.* pp. 13,424, 13,425.
[262] *Id.* p. 13,425.

After reviewing extensive comments, the FDIC issued a Notice of Propose Rulemaking limited to the implementation of FDI Act Sections 24(j) and 27.[263] The proposed rule with regard to Section 27 applies to banks and, by reference to OCC interpretations, to operating subsidiaries of banks. It does not refer at all to agents or other affiliated parties of a bank. Further, the proposal to use GLBA § 104(d) as a ground for preemption of state laws has been dropped. The comment period for the proposed rule extended to December 13, 2005, and there is no assurance that the requested rule will be finally adopted, even with its diminished scope.

The foregoing discussion makes clear that the FDIC, arguably the federal agency empowered to interpret the FDI Act, when presented with the opportunity to officially interpret the preemptive effect of federal law generally and Section 27 in particular, has not extended such preemption to third party providers such as AANC.

AANC has also argued that an adverse ruling by the Commissioner in this matter will somehow inhibit the use of third party marketing arrangements by state-chartered banks.[264] That said, its evidence does not show with any specificity how an adverse ruling in this matter will adversely affect any activities of state-chartered banks. This argument is of no effect.

Summary

For the reasons set forth above, I find that AANC is not exempt from the provisions of the CFA under Sections 53-190 or 53-191 thereof; and that enforcement of the CFA by the Attorney General or the Office of Commissioner of Banks is not preempted by the FDI Act or the United States Constitution. With regard to its arguments under G.S. § 53-191 and federal preemption, AANC has failed to show that it is a person operating under the authority of a federal banking law, or that any principles of federal preemption control to the application of the CFA to its operations in North Carolina.

Are the Attorney General and Commissioner of Banks Estopped from Enforcing the CFA Against AANC?

AANC argues that the prior inconsistent conduct of the Attorney General and OCOB prevent enforcement of the CFA under principles of "quasi-estoppel" and / or "equitable estoppel." For reasons set forth below, these arguments are ineffective.

Quasi Estoppel

The term "quasi estoppel," in its modern usage, was defined by the North Carolina Court of Appeals in 1976.[265]

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[263] Federal Deposit Insurance Corporation, Notice of Proposed Rulemaking, Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60,019 (October 14, 2005).
[264] Respondent's Brief, pp. 79-81.
[265] *Redevelopment Com. of Greenville v. Hannaford*, 29 N.C. App. 1, 4 (1976).

> 'Quasi estoppel,' ... *has its basis in acceptance of benefits*. [internal citations omitted] Where one having the right to accept or reject a transaction or instrument *takes and retains benefits* thereunder, he ratifies it, and cannot avoid its obligation or effect by taking a position inconsistent with it."[266]

Quasi estoppel, while similar in concept to equitable estoppel, is different from it.[267] Equitable estoppel requires evidence of detrimental reliance by one party on the statements of another while quasi estoppel conclusively presumes detrimental reliance because the party which is estopped has received benefits from the other.[268]

Since 1976, "quasi estoppel" has been used in thirty cases reported by the North Carolina appellate courts. In *all* of those cases, except for one cited by AANC,[269] which is addressed below, the outcome of the quasi estoppel issue turned on whether or not the party denying its burdens in a dispute--typically a contract dispute--had received benefits. A party which receives benefits cannot deny the burdens which accompany them.[270]

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[266] *Id.* at 4 (emphasis added).

[267] *Gupton v. Builders Transport*, 83 N.C. App. 1, 7 (1986), *rvs'd on other grounds*, *Gupton v. Builders Transport*, 320 N.C. 38, 357 S.E.2d 674 (1987).

[268] *Id.*

[269] *Holland Group, Inc. v. North Carolina Dep't of Admin.*, 130 N.C. App. 721 (1998).

[270] *See, e.g.*, *Whitacre P'ship v. BioSignia, Inc.*, 358 N.C. 1, 18 (2004) ("[The North Carolina Supreme] Court has also recognized that branch of equitable estoppel *known as 'quasi-estoppel' or 'estoppel by benefit.'*" (emphasis added); *Pinehurst v. Regional Inv. of Moore, Inc.*, 330 N.C. 725, 730 (1992) (finding plaintiff's quasi estoppel argument unfounded when the benefits defendant allegedly received were insubstantial); *Beck v. Beck*, 163 N.C. App. 311, 315 (2004) (holding that receipt of a benefit is "necessary to support the application of quasi-estoppel"); *Parkersmith Props. v. Johnson*, 136 N.C. App. 626, 632 (2000) (holding that plaintiff's argument for quasi estoppel has no merit when defendant has received no benefits from plaintiff); *Kennedy v. Kennedy*, 160 N.C. App. 1, 7 (2003) (holding that defendant is estopped from using a technicality to deny responsibility in a contract when it had accepted the benefits of the contract, and defining quasi estoppel as "estoppel by acceptance of benefits"); *Ellis v. White*, 156 N.C. App. 16, 24 (2003) (finding plaintiff is estopped from suing because he accepted benefits from defendant which justified defendant's actions and defining quasi estoppel as "estoppel by acceptance of benefits."); *County of Wake v. N.C. Dep't of Env't*, 155 N.C. App. 225, 240-41 (2002) (holding town estopped from contesting location of landfill when it had received benefits from its earlier acquiescence to the landfill); *Shell Island Homeowners Ass'n v. Tomlinson*, 134 N.C. App. 217, 277 (1999) (holding plaintiffs estopped from attacking the constitutionality of a regulatory scheme when they had benefited earlier from the same scheme). *See also Computer Decisions v. Rouse Office Mgmt.*, 124 N.C. App. 383, 387-88 (1996) and *B & F Slosman v. Sonopress, Inc.*, 148 N.C. App. 81 (2001) (both cases finding that quasi estoppel argument has no merit when defendant has accepted no benefits from plaintiff); *Carolina Medicorp v. Board of Trustees of the Teachers' & State Employees' Comprehensive Major Medical Plan*, 118 N.C. App. 485 (1985) (estopping plaintiff from challenging contracts on the basis that defendant did not follow state law, i.e. competitive bids, when plaintiffs had benefited from the contracts); *Land-of-Sky Regional Council v. County of Henderson*, 78 N.C. App. 85, 92 (1985) (holding county government estopped from denying its membership in a regional council and from withholding its share of the budget when the county had benefited from the work of the council). *See also Taylor v. Taylor*, 321 N.C. 244, 251 (1987) (holding wife estopped from denying existence of bigamous marriage when she sought alimony from her first husband); *Amick v. Amick*, 80 N.C. App. 291, 295 (1986) (ruling husband estopped from denying divorce on account of legal defect when he had enjoyed the benefits of the divorce); *and Mayer v. Mayer*, 66 N.C. App. 522, 535 (1984), (estopping husband # 2 from denying the validity of wife's foreign divorce in her first marriage

AANC cites two cases in support of its quasi estoppel defense, which are easily distinguishable from the facts of this case. First, AANC cites *Godley v. Pitt County.*[271] *Godley* is no different from the quasi estoppel cases discussed above. In *Godley*, an insurance company which had received premiums on behalf of an employee was estopped from later using a technicality in the governmental entity's employee classification to deny paying the employee's claim.[272] Simply put, the insurance company had accepted benefits under a contract, and it was therefore estopped from later denying the burdens created by that contract.[273] AANC in particular relies on one sentence from *Godley*, "quasi estoppel, which does not require detrimental reliance per se by anyone, but is directly grounded instead upon a party's *acquiescence* or acceptance of payment or benefits, by virtue of which that party is thereafter prevented from maintaining a position inconsistent with those acts."[274]

AANC clings to the word "acquiescence" to imply that since the OCOB and the OAG did not take legal action against it from the sunset of North Carolina's payday lending law in August 2001 until commencing this action in August of 2004, somehow those two offices by this "acquiescence" are now estopped from enforcing the law. In light of the clear meaning of quasi estoppel in North Carolina discussed above, AANC has misconstrued the meaning of "acquiesce." The meaning of "acquiesce" cannot be interpreted apart from the phrase "acceptance of benefits." The court in *Godley* was simply acknowledging that a party need not affirmatively accept benefits--for example, cashing a check--for quasi estoppel to apply. It is quite possible for a party to benefit by simply remaining silent (acquiescing); for example, a property owner who silently watches as the town constructs a public road on its property is estopped from later asserting that it owns the road.[275]

Even if the OAG and the OCOB had declined to attack AANC's continued payday lending, the joint action by the OAG and the OCOB in Wake County Superior Court in January 2002 against one of AANC's competitors, ACE Cash Express, seeking to enjoin it from "making usurious. . . 'payday loans,'" proves conclusively that OAG and OCOB did not acquiesce to continued payday lending after the sunset of G.S. 53-281. AANC cannot wrest the word "acquiescence" from its clear context in North Carolina quasi estoppel law to claim that the OAG and the OCOB are now estopped from enforcing the law of this state.

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when husband # 2 encouraged and participated in foreign divorce and sought to use its invalidity of that divorce to escape an obligation to pay alimony.)

[271] 306 N.C. 357 (1982).

[272] *Id.*

[273] *Id.*

[274] Respondent's Brief at 61 (quoting *Godley* at 361 (quoting 31 C.J.S. Estoppel § 107 (1964)) (emphasis by Respondent)).

[275] *In re Southern Ry. Co. Paving Assessment*, 196 N.C. 756 (1929).

AANC also seeks refuge in *Holland Group, Inc. v. North Carolina Dep't of Admin.*.[276] The issue in *Holland Group* was a particular statute, G.S. § 150B-44, which "provide[s] procedural protection" by defaulting to an administrative law judge's (ALJ) recommendation when a state agency does not act to accept or reject that recommendation in a timely manner after it receives the official record of the ALJ's proceeding."[277] In *Holland Group*, the agency was estopped from denying that it had received the official record, when the agency in so doing was really seeking more time before the ALJ's recommendation would be presumed to be the agency's final decision.[278]

In a very narrow holding, grounded in the procedural protections of G.S. § 150B-44, the *Holland Group* court expanded the conclusive presumption of detrimental reliance in which the doctrine of quasi estoppel is rooted to include a situation where 1) a statute is very precise in establishing a procedural safeguard; 2) a state official signs a document which bears his or her department's official caption, and the document has been officially filed with the Attorney General, accompanied by a certificate of service; *and* 3) only the state agency has the means to determine whether or not the contents of the document are true.

Holland Group cannot be reasonably stretched to grant AANC a conclusive presumption of detrimental reliance where there is no statute requiring the OAG and OCOB to prosecute actions under the CFA within a certain period of time, where the document supposedly relied on by AANC were simply efforts by the AG to lobby for legislation based on his understanding of *federal* law that has been evolving all through that time, and where many of the statements relied on by AANC are its president's self-serving testimony of what was said in private meetings with the Attorney General.

AANC has no claim whatsoever to a quasi estoppel defense. It is not entitled to any conclusive presumption of detrimental reliance based on the rule that presumes detrimental reliance when one party receives benefits from another. There is no allegation that the OAG or the OCOB received any benefit from AANC which would require either of them to bear the burden of failing to enforce the law which they have sworn to uphold. Nor is AANC entitled to a conclusive presumption of detrimental reliance under *Holland Group*'s very narrow application of quasi estoppel to a state agency.

Equitable Estoppel

In General

Equitable estoppel is akin to fraud; the fundamental difference is that scienter is not required.[279] The party which is estopped need not have intended to defraud another, but

[276] 130 N.C. App. 721 (1998).
[277] G.S. § 150B-44.
[278] *Holland Group* at 726-727.
[279] *Maxton Auto Company, Inc. v. Rudd.* 176 N.C. 497, 498-99 (1918).

at some point the one party's reliance on the representations of another cross a line from which equity and justice require that the estopped party be held to his words.[280] The essence of equitable estoppel is that a party 1) relied in good faith on the conduct of another and 2) "changed his position for the worse."[281]

More precisely, a party seeking to prevail on a claim of equitable estoppel bears the burden of proving six elements:

> (1) The conduct to be estopped must amount to false representation or concealment of material fact or at least which is reasonably calculated to convey the impression that the facts are other than and inconsistent with those which the party afterwards attempted to assert;
>
> (2) Intention or expectation on the party being estopped that such conduct shall be acted upon by the other party or conduct which at least is calculated to induce a reasonably prudent person to believe such conduct was intended or expected to be relied and acted upon;
>
> (3) Knowledge, actual or constructive, of the real facts by the party being estopped;
>
> (4) Lack of knowledge of the truth as to the facts in question by the party claiming estoppel;
>
> (5) Reliance on the part of the party claiming estoppel upon the conduct of the party being sought to be estopped;
>
> (6) Action based thereon of such a character as to change his position prejudicially.[282]

Further, a party cannot rely on equitable estoppel if it "was put on inquiry as to the truth and had available the means for ascertaining it."[283]

The first element requires that the party making the statement or concealment intend to convey an impression that is inconsistent with the facts. To make such a charge against the North Carolina's duly elected chief law enforcement officer and its Commissioner of Banks is quite serious. In fact, AANC has not alleged any such intention by the OAG or the OCOB in its legal argument. In not even alleging any intent to convey an impression

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[280] *Id.*
[281] *Meehan v. Lawrance*, 166 N.C. App. 369, 377 (2004).
[282] *Parkersmith Props. v. Johnson*, 136 N.C. App. 626, 633 (2000) (quoting *State Farm Mut. Auto. Ins. Co. v. Atlantic Indemnity Co.*, 122 N.C. App. 67, 75, 468 S.E.2d 570, 574-75 (1996) (citations omitted)).
[283] *Parkersmith Props.* at 634 (quoting *Hawkins v. Finance Corp.*, 238 N.C. 174, 179, 77 S.E.2d 669, 673 (1953)).

that is inconsistent with the facts on the part of these officials, AANC has certainly failed to prove it.

Similarly with the second element: AANC has not alleged that the OAG or the OCOB intended for AANC to rely on the statements in question. Many of the statements which AANC offered as background were efforts by the OAG to lobby in favor of certain legislation. Even if the statements which AANC alleges were made by the OAG directly to AANC's management were in fact actually made, AANC has not proven that the AG intended for AANC to rely on them. This argument might conceivably have a place (though we doubt it would prevail) if AANC pled a defense of entrapment in a criminal proceeding, but this is not a criminal proceeding.

The third element requires knowledge of the real facts by the party being estopped. It cannot be denied that the law regarding whether "rent-a-charter" arrangements provide a safe harbor from state consumer protection law has been a subject of much debate since August 2001. The OAG's *ad hoc* opinions, which have no indicia of being official pronouncements, cannot reasonably be construed as knowledge of facts. This is especially true of "rent-a-charter" arrangements with state banks, which arose only after the OCC made it clear in 2002 and 2003 that such "rent-a-charter" arrangements were not acceptable for national banks.

The fourth element requires a lack of knowledge of the facts on the part of the party seeking estoppel. One of AANC's key strengths, according to its public filings with the SEC, is its ability to stay on top of laws and regulations which affect its industry. The industry group (CFSA) in which AANC and its Parent play a key part has issued numerous pronouncements concerning the state of the law concerning "rent-a-charter" arrangements, and neither AANC nor Parent can credibly assert that it had no such knowledge. It should also be noted that actual knowledge is not even required. If AANC were put on notice as to the truth and had the means to find it out, it may not claim estoppel. Surely the two memoranda issued by the Commissioner at the time of the sunset created some knowledge on the part of AANC. Surely the OAG's and OCOB's joint action against ACE Cash Express in 2002 should have put AANC on notice as to how the state of North Carolina regarded payday lending through "rent-a-charter" arrangements, and the publicly filed complaint against ACE provided AANC with ample opportunity to find out this fact.

Fifth, AANC must prove that it relied on the assertions made by the OAG and the OCOB. AANC was doing business under G.S. 53-281, the statute which authorized payday lending, before the sunset of that provision on August 31, 2001. It continued to do business after the sunset of that provision in substantially the same manner as before. The record is devoid of evidence that AANC made large investments in its payday lending business after its authorization to do that business expired. AANC simply continued doing business just as it had before August 31, 2001.

Lastly, a party claiming equitable estoppel must prove that it has changed its position prejudicially, and be worse off than it had been if it had not relied on the other party's assertions. AANC booked over ten million dollars in profits from its North Carolina payday lending activities in 2004 (over 10% of its total profits earned in the 34 states where it does business). To say AANC has not been harmed by its alleged reliance on OAG or NCCOB is an understatement.

Estoppel of State Government

Even if AANC could prove the six elements of equitable estoppel listed above, the State cannot be estopped from exercising its governmental functions. North Carolina courts make a careful distinction between governmental functions and proprietary functions before applying estoppel to governmental entities.[284] A governmental function is something *only* a governmental entity can do; a proprietary function is something any "corporation, individual or group of individuals" can do.[285]

The State cannot be estopped from exercising its governmental functions even in an egregious case where harm can be easily proved. In *Henderson v. Gill*,[286] an agent of the Revenue Department (RD) advised a business owner that it need not collect and remit sales tax on a part of its sales. Relying on this advice, the business did not collect the taxes.[287] Later, the RD forced the business to remit sales tax on all of its sales, including the portion which it had not collected because of the advice of the RD agent.[288] When the business sued the State a return of those taxes under a theory of estoppel, the court ruled in favor of the State.[289] Not only did the court not prevent the RD from collecting the tax prospectively, but it also even allowed the RD to collect the tax retroactively, an act strongly akin to an *ex post facto* law. The court reasoned, first of all, that estopping the state from exercising its governmental functions would lead to chaos and endless disputes.[290] Secondly, agents of the State do not have the power to change the law.[291] By the authority of *Henderson,* the Commissioner and the Attorney General would not only have the power to enforce N.C. usury law against AANC prospectively, he would also have the authority to enforce it retroactively by declaring all prior loans null and void!

Both of the cases which AANC cites in support of its equitable estoppel argument, *Mulberry-Fairplains Water Ass'n v. North Wilkesboro,* and *Land-of-Sky Regional Council v. County of Henderson*,[292] clearly involve the government in its proprietary functions--that is, contracts made by the governmental entity which it later sought to escape. In contrast, enforcement of North Carolina usury law is plainly the exercise of a governmental function, which North Carolina law expressly gives to the COB.

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[284] *See, e.g.*, *Mulberry-Fairplains Water Ass'n v. North Wilkesboro*, 105 N.C. App. 258, 264 (1992).
[285] *Tabor v. County of Orange*, 156 N.C. App. 88, 91 (2003) (emphasis added).
[286] 229 N.C. 313 (1948).
[287] *Id.* at 314.
[288] *Id.* at 314-15.
[289] *Id.* at 316.
[290] *Id.*
[291] *Id.*
[292] 78 N.C. App. 85 (1985).

AANC's equitable estoppel argument is doubly without merit. First of all, AANC cannot prove even one of the six elements of equitable estoppel. Furthermore, even if AANC could prove *all* the six elements of equitable estoppel, it would still not be able to estop the government of the state from exercising the clear governmental function of enforcing the law.

Legal Conclusions

Based on a review of the record in this matter and the analysis of relevant legal authorities discussed above, I find:

1. AANC is a person engaged in the business of lending in North Carolina, as those terms are used in the CFA.

2. At all times since August 31, 2001, and, in particular, from February 1, 2005 through September 15, 2005, AANC contracted for, exacted and received indirectly charges in respect of loans covered by the CFA that substantially exceeded the levels of charges permitted by Chapter 24 or the CFA.

3. At all times since August 31, 2001, and, in particular, from February 1, 2005 through September 15, 2005, AANC violated the normative provisions of the CFA through the receipt of the compensation referred to in paragraph 2 of these Legal Conclusions.

4. AANC is not exempt from the CFA under G.S. § 53-190 or G.S. § 53-191.

5. Enforcement of the CFA against AANC is not preempted by the Federal Deposit Insurance Act or the United States Constitution.

6. Neither the Attorney General nor the Commissioner of Banks is estopped to enforce the CFA against AANC by the equitable principles of quasi-estoppel or equitable estoppel.

As a result of the foregoing, I further find by a clear preponderance of the evidence presented to me, that the grounds for issuance to AANC of an order to cease and desist have been established.

III. ORDER

1. Based on the foregoing findings, the Commissioner hereby orders Advance America Cash Advance Centers of North Carolina, Inc. immediately to cease and desist from the further operation of its payday advance centers in North Carolina, to the extent that they make payday loans, whether on behalf of FFB or any other insured depository institution.

2. Any violation of this Cease and Desist Order may result in the imposition of civil or criminal penalties pursuant to the provisions of G.S. § 53-166 and further injunctive relief under G.S. § 53-187.

3. This Order may be appealed by giving written notice within 20 days of the service hereof to the State Banking Commission pursuant to G.S. § 53-92(d), to which reference is hereby made. Any appeal to the State Banking Commission should be mailed to the attention of:

   Daniel E. Garner, Executive Legal Specialist
   316 W. Edenton Street
   4309 Mail Service Center
   Raleigh, NC 27699-4309

   If you have any questions concerning an appeal of this Order, Mr. Garner may be contacted at (919) 733-3016 or by fax at (919) 733-6918.

This the 22nd day of December, 2005.

[redacted]

Joseph A. Smith, Jr.
Commissioner of Banks

CERTIFICATE OF SERVICE

THE UNDERSIGNED hereby certifies that he has this day served a copy of the foregoing Order by facsimile and by placing a copy of the same in the mail, at Raleigh, first class mail, postage prepaid and addressed to the persons listed below:

This the 22nd day of December, 2005.

[redacted]

Daniel E. Garner, Executive Legal Specialist
Office of the Commissioner of Banks
4309 Mail Service Center
Raleigh, North Carolina 27699-4309
Phone: (919) 733-3016
Fax: (919) 733-6918

Saul M. Pilchen
Benjamin B. Klubes
Lesley B. Whitcomb
Valerie L. Hletko
Skadden, Arps, Slate, Meagher & Flom, LLP
1440 New York Avenue, NW
Washington, District of Columbia 20005
Fax: (202) 661-9070

Donald C. Lampe
Womble Carlyle Sandridge & Rice, PLLC
One Wachovia Center
301 South College Street, Suite 3500
Charlotte, North Carolina 28202
Fax: (336) 574-4530

Christopher W. Jones
Johnny M. Loper
Womble Carlyle Sandridge & Rice, PLLC
150 Fayetteville Street Mall
Raleigh, North Carolina 27602
Fax: (919) 755-6771

Joshua Stein
Senior Deputy Attorney General
N.C. Department of Justice
9001 Mail Service Center
Raleigh, North Carolina 27699-9001
Fax: (919) 716-6050

Philip A. Lehman
Assistant Attorney General
N.C. Department of Justice
9001 Mail Service Center
Raleigh, North Carolina 27699-9001
Fax: (919) 716-6050

L. McNeil Chestnut
Special Deputy Attorney General
N.C. Department of Justice
9001 Mail Service Center
Raleigh, North Carolina 27699-9001
Fax: (919) 716-6755

J. Jerome Hartzell (Counsel for Amicus-Intervenor)
Hartzell & Whiteman, LLP
2626 Glenwood Avenue, Suite 500
Raleigh, North Carolina 27608
Fax: (919) 571-1004

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