NO. 07-3289

**IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT**

QUIK PAYDAY INC.,
Plaintiff-Appellant,

v.

STORK, et al.,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF KANSAS

BRIEF OF THE ONLINE LENDERS ALLIANCE AND AMERICANS FOR TAX REFORM AS *AMICI CURIAE* IN SUPPORT OF PLAINTIFF-APPELLANT, SUPPORTING REVERSAL

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CORPORATE DISCLOSURE STATEMENT

In accordance with Federal Rules of Appellate Procedure 26.1 and 29(c) *amicus* Americans for Tax Reform states that it is a non-stock corporation; that it has no parent corporation, and therefore no publicly-traded corporation owns 10 percent or more of its stock.

TABLE OF CONTENTS

Page

CORPORATE DISCLOSURE STATEMENT i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

INTEREST OF *AMICI CURIAE* 1

BACKGROUND 3

A. Payday Loans 3

B. The Payday Loan Market 5

C. Mechanics of an Online Payday Loan 9

D. The Online Payday Loan Business Model 10

E. Kansas's Regulatory Regime 10

F. The District Court's Decision 13

ARGUMENT 14

I. THE DISTRICT COURT ERRED BY FAILING TO FOLLOW CONTROLLING PRECEDENT HOLDING THAT INTERSTATE INTERNET COMMERCE REQUIRES NATIONAL UNIFORMITY 15

II. THE DISTRICT COURT FAILED TO RECOGNIZE THAT §16-a-201's "PRACTICAL EFFECT" IS TO EXPORT KANSAS'S REGULATIONS TO WHOLLY EXTRATERRITORIAL TRANSACTIONS 15

III. ENFORCEMENT OF STATUTES LIKE THE KCCC WILL IMPERMISSIBLY SUBJECT OUT-OF-STATE ONLINE LOAN TRANSACTIONS TO INCONSISTENT STATE REGULATIONS 21

IV. THE DISTRICT COURT ERRED IN CONCLUDING THAT THE KCCC DOES NOT IMPOSE A BURDEN ON INTERSTATE COMMERCE EXCESSIVE RELATIVE TO ITS MARGINAL LOCAL BENEFITS 24

CONCLUSION 30

TABLE OF AUTHORITIES

Page(s)

CASES

ACLU v. Gonzalez,
478 F. Supp. 2d 775 (E.D. Pa. 2007)....................18

ACLU v. Johnson,
194 F.3d 1149 (10th Cir. 1999)....................13, 15, 25, 27

Aldens, Inc. v. Ryan,
571 F.2d 1159 (10th Cir. 1978)....................13, 25

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449 U.S. 302 (1981)....................20

American Libraries Association v. Pataki,
969 F. Supp. 160 (S.D.N.Y. 1997)....................26

A.S. Goldmen & Co. v. New Jersey Bureau of Securities,
163 F.3d 780 (3d Cir. 1999)....................19

Bibb v. Navajo Freight Lines, Inc.,
359 U.S. 520 (1959)....................30

Bigelow v. Virginia,
421 U.S. 809 (1975)....................20

Blue Circle Cement, Inc. v. Board of County Commissioners,
27 F.3d 1499 (10th Cir. 1994)....................14, 26

Brown-Forman Distillers Corp. v. New York State Liquor Authority,
476 U.S. 573 (1986)....................16

Cambridge Credit Counseling Corp. v. Foulston,
303 F. Supp. 2d 1188 (D. Kan. 2003), *vacated by* No. 03-3317, 2004 WL 3266802 (10th Cir. Oct. 19, 2004)....................20

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481 U.S. 69 (1987)....................21

Dean Foods Co. v. Brancel,
187 F.3d 609 (7th Cir. 1999) 20

Edgar v. MITE Corp.,
457 U.S. 624 (1982)..16, 26, 30

Healy v. Beer Institute,
491 U.S. 324 (1989)..16, 22, 28

Hunt v. Washington State Apple Advertising Commission,
432 U.S. 333 (1977)..26

In re Vonage Holdings Corp.,
19 F.C.C.R. 22,404 (2004) 21

Kassel v. Consolidated Freightways Corp.,
450 U.S. 662 (1981)..30

Knoll Pharmaceutical Co. v. Sherman,
57 F. Supp. 2d 615 (N.D. Ill. 1999)..21

NCAA v. Miller,
10 F.3d 633 (9th Cir. 1993) 24

People v. Fairfax Family Fund, Inc.,
235 Cal. App. 2d 881 (Cal. App. Ct. 1964)...................................20

Pike v. Bruce Church, Inc.,
397 U.S. 137 (1970)..24

Quik Payday, Inc. v. Stork,
509 F. Supp. 2d 974 (D. Kan. 2007) .... *passim*

Southern Pacific Co. v. Arizona ex rel. Sullivan,
325 U.S. 761 (1945)..26

Stroman Realty, Inc. v. Antt,
Civ. No. H-98-283, 2005 U.S. Dist. LEXIS 16048
(S.D. Tex. July 28, 2005)..20, 24, 26, 28

CONSTITUTIONAL PROVISIONS AND STATUTES

U.S. Const. art. I, § 8, cl. 3 14

Ariz. Rev. Stat. § 6-1251 23

815 Ill. Comp. Stat. Ann. 122/1-1 *et seq.* 29
815 Ill. Comp. Stat. Ann. 122/1-15 23

Kan. Stat. Ann. § 16a-1-101 *et seq.* 10
Kan. Stat. Ann. § 16a-1-201(1) 11
Kan. Stat. Ann. § 16a-1-201(1)(a) 22
Kan. Stat. Ann. § 16a-1-201(4)(a) 17
Kan. Stat. Ann. § 16a-1-201(6) 11
Kan. Stat. Ann. § 16a-1-201 cmt. 2 17
Kan. Stat. Ann. § 16a-2-301 11
Kan. Stat. Ann. § 16a-2-302(1)(b) 11
Kan. Stat. Ann. § 16a-2-302(1)(d) 11
Kan. Stat. Ann. § 16a-2-302(2)(a) 11
Kan. Stat. Ann. § 16a-2-302(2)(b) 11
Kan. Stat. Ann. § 16a-2-304(1) 12
Kan. Stat. Ann. § 16a-2-404 *et seq.* 29
Kan. Stat. Ann. § 16a-2-404 12
Kan. Stat. Ann. § 16a-2-404(1) 12
Kan. Stat. Ann. § 16a-2-404(2) 12
Kan. Stat. Ann. § 16a-2-404(3) 12
Kan. Stat. Ann. § 16a-2-404(4)(a) 12
Kan. Stat. Ann. § 16a-2-404(4)(b) 12
Kan. Stat. Ann. § 16a-2-404(6) 12
Kan. Stat. Ann. § 16a-2-404(12) 11

La. Rev. Stat. Ann. § 9:3557 23
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Mont. Code Ann. § 31-1-701 *et seq.* 29

Neb. Rev. Stat. § 45-919(f) 23

Okla. Stat. tit. 14A, § 1-201(1)(c) 23
Okla. Stat. tit. 59, § 3109(D) 23

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Mayday for Payday Loans, Wall St. J., Apr. 2, 2007, at A16 .... 4, 5, 7, 8

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Donald P. Morgan & Michael R. Strain, Federal Reserve Bank of New York, *Payday Holiday: How Households Fare After Payday Credit Bans,* Staff Report No. 309 (2007), *available at* http://www.ny.frb.org/research/staff_reports/sr309.html 7

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INTEREST OF *AMICI CURIAE*[1]

The Online Lenders Alliance ("OLA") is a professional trade association representing the growing industry of U.S. based companies offering online consumer micro-loans, also known as payday loans. OLA was founded by a small group of industry leaders who believed that the availability of short term, unsecured micro-credit could be threatened without standardizing principles by which these loans are made over the internet. Since OLA's inception, consumer demand for online micro-loans has surged and membership has grown in parallel capacity.

A typical OLA lender member is registered and regulated by its home state and has agreed to comply with all applicable state and federal laws, including the Truth in Lending Act ("TILA"). Additionally, OLA has elected, as a condition of membership, to have all member companies abide by a List of Best Practices and Code of Conduct, to ensure they are using all lending products and practices responsibly and that customers are fully informed and fairly treated. OLA supports a single-state model for its lender members, whereby the lender is registered, licensed, and regulated by its home state, all of its loan transactions are governed by the home state's regulatory regime, and it receives and defends against any

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[1] In accordance with Fed. R. App. P. 29(a), *amici* state that both parties have consented to the filing of this brief.

consumer complaints in that state. This is the same model followed by national and state-chartered banks, credit unions, and almost every other type of consumer credit provider operating in the interstate market.

The issues raised in this case are crucial to the continued vitality of the sector of the consumer micro-loan industry operating over the internet and to the ability of a growing number of consumers to access short-term, unsecured credit through this already well-regulated industry. The decision of the district court—holding that the terms of payday loans also can be subject to regulation by the borrower's state—will vastly increase operating costs and expose lenders to the threat of conflicting legal requirements and crippling legal uncertainty. OLA believes that, if affirmed, some providers will abandon the business entirely and others will flee to offshore havens with no effective regulatory controls. Either way, the free flow of interstate commerce will be stymied and American consumers needing credit—and left to borrow from unregulated offshore lenders or avail themselves of more expensive alternatives in a less-competitive market—will be disserved.

Americans for Tax Reform ("ATR") is a nonprofit, tax-exempt organization, incorporated in 1985 in the District of Columbia. It is a national grassroots organization that aims to increase public awareness about the size of government and complexity of governmental regulations, by advocating for lower taxes,

smaller government, and increased government financial accountability. ATR opposes unreasonable governmental intrusion into the free market, believing that such actions negatively impact personal freedoms and entrepreneurship. It is especially concerned with attempts by state governments to expand their regulatory authority extraterritorially and, in kind, has consistently opposed overreaching state regulatory regimes. ATR believes that the actions of the Kansas State Banking Commission ("KSBC"), as upheld by the district court in this case, threaten these interests and will have grave consequences for the free market.

Amici submit this brief in the belief that they can provide this Court valuable insights into the workings of, and consumer benefits provided by, online consumer credit, the practical problems that would be created by multiple and inconsistent state regulation of interstate loan transactions, and the attendant adverse effects on industry, consumers, and internet commerce at large.

BACKGROUND

A. Payday Loans

A payday loan is a short-term, unsecured consumer loan.[2] These loans are made for small amounts—typically, between \$100 and \$500—and for short

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[2] *See* Gregory Elliehausen & Edward C. Lawrence, Georgetown Univ., *Payday Advance Credit in America: An Analysis of Customer Demand* at 1 (2001) ("Georgetown").

terms—often two weeks or less.[3] As the name suggests, "payday" loans were designed to help consumers bridge the gap between paychecks.[4] As originally conceived, the consumer would provide a postdated check to cover principal and interest, and the lender would deposit that check on the consumer's next payday.[5]

Payday lending first emerged in its current form in the 1990s to fill a void in the marketplace created by bank deregulation.[6] In the 1980s, banks freed of traditional lending restrictions abandoned the small consumer loan business in search of more profitable ventures.[7] This left an unfilled demand for small, short-term consumer loans; payday lenders sprang up to fill this gap.[8]

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[3] *See* Donald P. Morgan, Federal Reserve Bank of New York, *Defining and Detecting Predatory Lending*, Staff Report No. 273, at 5 (2007), *available at* http://www.ny.frb.org/research/staff_reports/sr273.html ("Fed. Reserve"); *Mayday for Payday Loans*, Wall St. J., Apr. 2, 2007, at A16 ("WSJ"); Georgetown, *supra*, at 3.

[4] WSJ, *supra*; Press Release, OLA, *Federal Reserve Bank of New York Study Shows Payday Lending is Not "Predatory"* (Jan. 29, 2007), *available at* http://www.onlinelendersalliance.org/news.php ("OLA 1/29/07 Press Release").

[5] Georgetown, *supra*, at 1.

[6] Georgetown, *supra*, at 1-2; Community Financial Services Association ("CFSA"), *Community Financial Services Association of America's Analysis of the Payday Advance Industry* at 2 (2001) ("CFSA 2001 Analysis").

[7] *See* Georgetown, *supra*, at 1.

[8] *See* Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?*, FDIC Center for Financial Research Working Paper No. 2005-09, at 2-3 (June 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf ("FDIC Working Paper"); Rich Duprey, *Will Bubba Bring Back Payday Loans?*, Motley Fool, Feb. 7, 2007, *available at*

B. The Payday Loan Market

It has now been widely recognized that the payday loan industry offers a "valuable service" to a primarily educated and employed middle class market.[9] Most borrowers make between $25,000 and $50,000 in annual income, and more than 25% earn over $50,000.[10] Over 90% have at least a high school diploma and over 50% have attended college.[11] By definition, all borrowers must have a checking account; two-thirds have a savings account, and over half have a retirement account.[12]

Consumers often consider payday loans when faced with unexpected or temporary needs that cannot be met with cash on hand. Indeed, approximately 70% of borrowers take out payday loans to cover groceries, rent or mortgage payments, utility bills, car payments, or repairs.[13] The alternatives in these circumstances are often more costly and more cumbersome.[14]

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http://www.fool.com/investing/value/2007/02/07/will-bubba-bring-back-payday-loans.aspx.

[9] *See* WSJ, *supra* ("[P]ayday loans offer a valuable service to moderate income workers.").

[10] *See* WSJ, *supra*; Georgetown, *supra*, at 29.

[11] Georgetown, *supra*, at 33.

[12] *See* Cypress Research Group, *Payday Advance Customer Satisfaction Survey* at 22 (2004).

[13] OLA 1/29/07 Press Release, *supra*; Io Data Corp., *Payday Advance Customer Research Cumulative State Research Report* at 4 (2002).

[14] *See* WSJ, *supra*.

For example, faced with a $100 unpaid utility bill, a consumer short on cash can either (a) pay the bill by taking out a $100 payday loan for a fee of between $10 and $30, (b) allow the bill to go unpaid and pay a late fee (approximately $10) and reconnect fee (approximately $37) to the utility company, enduring the inconvenience of losing electricity in the interim, or (c) pay the bill with a check that will later bounce, resulting in an insufficient fund fee ("NSF") from the bank (approximately $25) and from the utility company (approximately $24), in addition to a blemished credit report.[15] Consumers face similar alternatives when unable to pay their rent (approximately $30 late fees), mortgage (approximately $25), car loan (approximately $20), or credit card bills (approximately $29).[16]

Another costly alternative is overdraft or "bounce" protection, whereby banks cover overdrawn checks for a fee of between $17-34 per check.[17] Although often more expensive than payday loans, and used for the same purposes, the fees associated with bounce protection programs are not considered "loans" for purposes of TILA, and thus the effective annual percentage rates ("APRs") are

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[15] *See* CFSA, *Payday Advance: A Cost Effective Alternative* (2002) ("CFSA, Cost Effective Alternative") (calculating average fees across states).

[16] *Id.*

[17] *See* Sheila Bair, Univ. of Massachusetts at Amherst, *Low-Cost Payday Loans: Opportunities and Obstacles, A Report by the Isenberg School of Management* at 10-11 (2005) ("Univ. of Massachusetts"); Alex Berenson, *Banks Encourage Overdrafts*, N.Y. Times, Jan. 22, 2003, at A1.

never disclosed.[18] As a recent study by the Federal Reserve Bank of New York revealed, "payday credit is cheaper than the bounce 'protection' that earns millions for credit unions and banks."[19] When faced with temporary or unexpected financial obligations, payday loans provide consumers with what is often the most convenient and cost-effective alternative.[20]

The common myth that payday loans are inordinately costly or overreaching simply ignores the alternatives. It also largely relies on the metric of APRs. Critics often point to high APRs, which generally range from approximately 260% (10% x 365/14) to 780% (30% x 365/14) for a typical two-week loan,[21] but using an annualized percentage calculation for a short-term loan is misleading. Just as nobody would use a taxi service to travel cross-country, nobody takes out a payday loan for a 12-month term.[22] Applying this same metric, credit cards charge 700%

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[18] Univ. of Massachusetts, *supra*, at 13.

[19] *See* Donald P. Morgan & Michael R. Strain, Federal Reserve Bank of New York, *Payday Holiday: How Households Fare After Payday Credit Bans*, Staff Report No. 309, at 3, 25-26 (2007), *available at* http://www.ny.frb.org/research/staff_reports/sr309.html (after states banned payday loans, depositors "paid an extra $36 million per year in bounced check fees").

[20] *See, e.g.*, Univ. of Massachusetts, *supra*, at 12.

[21] *See* Fed. Reserve, *supra*, at 5; WSJ, *supra*.

[22] *See* CFSA 2001 Analysis, *supra*, at 1.

or more, bounced check costs exceed 1300%; even a $1.44 ATM fee (with a one-day term) amounts to 526% APR.[23]

Payday loans do cost more, proportionately, than larger, longer-term loans. But, this is neither surprising nor "invidious."[24] Rather, it is the natural consequence of the fixed costs of lending.[25] Preparing a $100,000 loan payable over ten years is no more costly to the lender than preparing a $300 loan payable over two weeks. The difference is the long-term lender has ten years to recoup its origination and service costs; the payday lender has two weeks. Payday lenders also face added risk by offering their consumers convenience at the expense of foregoing an in-depth underwriting process.[26] And, finally, as a recent study by the Federal Reserve Bank of New York has shown, some of the high costs of payday lending may be attributable to burdensome state regulations that stifle competition.[27] States with the most onerous regulations invite the untoward consequence of increasing costs for the very borrowers they seek to protect.

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[23] *See* WSJ, *supra*; CFSA, Cost Effective Alternative, *supra*.

[24] *See* Fed. Reserve, *supra*, at 8.

[25] *Id.*; Georgetown, *supra*, at 4-5.

[26] *See* FDIC Working Paper, *supra*, at 4, 10, 19.

[27] *See* Fed. Reserve, *supra*, at 22-23.

C. Mechanics of an Online Payday Loan

Unlike traditional storefront loans—where the borrower provides an actual postdated check to be deposited when the loan is payable and due—OLA's online lenders operate from cyberspace and their loans are made and paid via ACH transfers. Also unlike storefront lenders, OLA members do not generally market directly to consumers. Rather, in the large majority of cases, the consumer initiates the process by searching for a lender via an online search, clicking on a "banner ad," or responding to a third-party email. All three methods typically direct the consumer to a "lead generator"—an entity dedicated to gathering loan applications from consumers and selling those applications to direct lenders. The consumer will then typically complete a generic application and the lead generator will market that application to online payday loan companies.

Only after a lender purchases the lead will it contact the applicant electronically with instructions for completing an online loan contract. OLA lenders provide full loan disclosure in compliance with all applicable state and federal laws, including TILA. Additionally, OLA lenders inform borrowers of their state of licensing, the state where the loan is deemed made, and which state law governs the transaction. After reviewing the loan agreement and these relevant disclosures, the applicant will authorize electronic deposits and withdrawals from its bank account via ACH transfer. Once the lender approves the application, it

will transfer the funds directly into the borrower's account and, upon maturity, withdraw the funds for repayment directly from that same account.

D. The Online Payday Loan Business Model

The internet provides consumers with several distinct advantages over storefront lending including convenience, safety, and enhanced privacy. These benefits have fostered strong consumer demand for OLA members' services with industry analysts projecting continued growth of approximately 40% per year.

Online operations, however, are riskier than storefront lending; a portfolio of online loans generally has default rates at least double those of its storefront counterparts, largely reflecting the increased risk of fraud.[28] Additionally, the marketing costs for an online loan are far in excess of those for a comparable storefront loan. And, online lenders have less diversified revenue streams than storefront lenders. As a result, online lenders operate on smaller margins and the costs of compliance with multiple state regulatory regimes would have an enormous impact on their viability.

E. Kansas's Regulatory Regime

Kansas purports to regulate online payday lenders through the provisions of its uniform consumer credit code, *see* Kan. Stat. Ann. §16a-1-101 *et seq*. (the

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[28] *See, e.g.,* University of Massachusetts, *supra*, at 19.

"KCCC"). The KCCC applies to "consumer credit transactions made in [Kansas]." §16a-1-201(1). A consumer credit transaction is "made in" Kansas if either:

> (a) A signed writing evidencing the obligation or offer of the consumer is received by the creditor in this state; or
>
> (b) the creditor induces the consumer who is a resident of this state to enter into the transaction by solicitation in this state by any means, including but not limited to: Mail, telephone, radio, television or any other electronic means.

Id. Under subsection (b), a loan by an out-of-state lender is "made in" Kansas and subject to the full panoply of Kansas regulations if: (1) a solicitation occurs in Kansas *and* (2) the consumer is a Kansas resident. A consumer's residence is determined by "the address given by the consumer as the consumer's residence in any writing signed by the consumer in connection with a credit transaction." §16a-1-201(6).

A lender who makes a loan "in this state"—*i.e.,* by in-state solicitation of a Kansas resident—must first procure a license. §16a-2-404(12). To obtain a license, a would-be lender must submit an application, §16a-2-301, and pay both a $425 initial licensing fee, §16a-2-302(1)(b), and a $325 annual licensing fee, §16a-2-302(1)(d).

The licensure requirement is only the beginning. Lenders must also post a surety bond of at least $100,000, §16a-2-302(2)(a), and demonstrate a "satisfactory" minimum financial worth, §16a-2-302(2)(b). And, a lender licensed

under this provision must "maintain records in conformity with generally accepted accounting principles and practices in a manner that will enable the administrator . . . to determine whether the licensee, assignee or servicer is complying with" Kansas law. §16a-2-304(1).

Under §16a-2-404, which specifically governs payday loans, "licensed or supervised lender[s]" (a) cannot charge more than 15% of the principal amount on loans, (b) cannot offer loans that exceed $500, (c) must limit loan terms to between 7-30 days, and (d) can only issue loans with respect to which a single repayment is expected. §16a-2-404(1), (2). The payday loan provision further prohibits lenders from having more than two such loans outstanding to the same borrower at the same time, or more than three in any 30 calendar day period. §16a-2-404(3). Each loan must contain a detailed disclosure of certain lending limitations in at least 10-point bold-face type in both English and Spanish, initialed by the borrower. §16a-2-404(4)(a), (b). And, lenders must maintain records of loan transactions for each borrower. §16a-2-404(3). Further, the lender is tasked with ensuring that "[a]ny loan made under this section" is not "repaid by proceeds of another loan made under this section by the same lender or related interest" and that "[t]he proceeds from any loan made under this section" are not "applied to any other loan from the same lender or related interest." §16a-2-404(6).

F. The District Court's Decision

The district court held that application of the KCCC to out-of-state online payday lenders does not violate the dormant Commerce Clause, finding this Court's 1978 decision in *Aldens, Inc. v. Ryan*, 571 F.2d 1159, controlling. *Aldens*—a case about an "Illinois mail-order house that solicited business in Oklahoma by mailing catalogues and flyers to Oklahoma residents" *in* Oklahoma—was deemed to stand for the broad proposition that any "state's regulation of the cost and terms on which its residents borrow money from an out-of-state creditor is not outweighed by the burdens on interstate commerce . . . ." *Quik Payday, Inc. v. Stork*, 509 F. Supp. 2d 974, 978, 979 (D. Kan. 2007). The court dismissed the many factual and legal distinctions between this case and *Aldens*, and distinguished this Court's far more recent and relevant decision in *ACLU v. Johnson*, 194 F.3d 1149 (10th Cir. 1999), holding a statute criminalizing the dissemination of indecent material to minors via the internet to violate the Commerce Clause.

The district court then "easily rejected" the argument that the KCCC had the impermissible "practical effect" of applying to wholly extraterritorial conduct. *Quik Payday*, 509 F. Supp. 2d at 981. In doing so, the court repeatedly conflated the borrower's state of residence with his or her physical location at the time of "solicitation," and dismissed the real possibility that "a Kansas consumer [might]

access[] its website and complete[] the transaction with plaintiff while using a computer outside Kansas" as a mere "hypothetical." *Id.* at 982.

Finally, the court held that permitting states like Kansas to regulate out-of-state lenders would not subject such lenders to inconsistent (and at times conflicting) state regulations in contravention of the Commerce Clause—by simply presuming, contrary to the evidence, that "Plaintiff and other internet payday lenders are not in danger of having inconsistent regulations from several states apply to the same transactions." *Id.* at 984.

ARGUMENT

The Commerce Clause provides Congress with the power to "'regulate Commerce . . . among the several States.'" U.S. Const. art. I, §8, cl. 3. The affirmative grant of authority to the federal government "impliedly confines the states' power to burden interstate commerce." *Blue Circle Cement, Inc. v. Bd. of County Comm'rs*, 27 F.3d 1499, 1511 (10th Cir. 1994). This "dormant" aspect of the Commerce Clause "den[ies] 'the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce.'" *Id.* (citation omitted).

The Bank Commissioner's application of the KCCC to online payday loans by out-of-state lenders impermissibly applies Kansas law to transactions that occur entirely beyond the state's borders, subjects lenders to multiple and inconsistent

state regulations, and excessively burdens interstate commerce relative to its attenuated local benefits. In holding otherwise, the district court erred in several respects.

I. THE DISTRICT COURT ERRED BY FAILING TO FOLLOW CONTROLLING PRECEDENT HOLDING THAT INTERSTATE INTERNET COMMERCE REQUIRES NATIONAL UNIFORMITY

When commerce is conducted over certain types of mediums, like railroads and highways, the consequences of applying a multitude of varying state laws are so severe and pervasive that they necessitate a nationally cohesive scheme of regulation and single uniform rule. Those consequences—impingement upon extraterritorial conduct, enforcement of inconsistent state regulations, and imposition of undue burdens on interstate commerce—call for uniform national regulation as a categorical matter. As this Court held in *Johnson*, the internet is just such a medium. 194 F.3d at 1162. The need for national unity in the regulation of internet commerce has been fully and ably canvassed by Quik Payday and, to avoid duplication, will not be repeated here. But application of this "national unity" rule should decide this case and mandate reversal.

II. THE DISTRICT COURT FAILED TO RECOGNIZE THAT §16-a-201's "PRACTICAL EFFECT" IS TO EXPORT KANSAS'S REGULATIONS IMPERMISSIBLY TO WHOLLY EXTRATERRITORIAL TRANSACTIONS

It is black-letter law that the "'Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the

State's borders, whether or not the commerce has effects within the State.'" *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989) (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982) (plurality opinion) (alteration in original)). This prohibited extraterritorial reach does not have to be explicit; "[t]he critical inquiry is whether the ***practical effect*** of the regulation is to control conduct beyond the boundaries of the State." *Id.* (citing *Brown-Forman Distillers Corp. v. N.Y. State Liquor Auth.*, 476 U.S. 573, 579 (1986)) (emphasis added).

Here, the district court "easily rejected" Quik Payday's argument that the KCCC impermissibly regulates out-of-state transactions, on the strength of the statute's requirement that a creditor "induce[] the consumer . . . to enter into the transaction by *solicitation in the state*." *Quik Payday*, 509 F. Supp. 2d at 981 (quoting §16-a-201(1)(b)) (emphasis added). But as discussed above, the question is not what the statute says but what the "practical effect" of that statute is. Because neither the regulators nor the regulated lender can feasibly ascertain whether an online "solicitation" is occurring in Kansas, and the penalties imposed are so severe, online payday lenders must presume that all loans to Kansas residents are governed by Kansas law even though, in reality, some of those loans

have no significant nexus to Kansas—and the KCCC thereby has the unconstitutional "practical effect" of regulating extraterritorial loan transactions.[29]

Part of the problem is definitional. As the official commentary acknowledges, the statute provides "[n]o guidance . . . on when a solicitation is made in Kansas or what role any solicitation that is deemed to have been made in Kansas must have played in the consumer's decision to enter into the transaction." §16a-1-201 cmt. 2. To the extent the term is given its ordinary meaning, OLA members "solicit" only rarely. The overwhelming majority are introduced to their borrowers only after *the consumer* has initiated contact through a third party lead generator. The first interaction between the online lender and the borrower is usually consummation of the loan by means of an electronic signature and authorization for ACH transfer.

Even in those cases where there is "solicitation," the lender cannot practically ascertain whether that "solicitation" occurred *in Kansas*. In today's world, state residency is not an adequate proxy for physical location of a consumer

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[29] The statute also has the *direct* effect of regulating entirely out-of-state transactions. Kansas applies some of its regulations—namely its usury laws—to payday loan transactions with Kansas residents *regardless* of whether the transaction occurs entirely out of state. §16a-1-201(4)(a) (A creditor engaged in "[a] consumer credit transaction *made in another state* to a person who is a resident of this state at the time of the transaction . . . may not collect charges through actions or other proceedings in excess of those permitted by" Kansas law). On the most basic level, this directly regulates commerce taking place "wholly outside" Kansas's borders.

on the internet. Travelers regularly access the internet, as do military personnel and college students. Residents who live near bordering states regularly work (and access the internet) across state lines. This is not a mere "hypothetical." *Quik Payday*, 509 F. Supp. 2d at 982. Kansas City alone would provide tens of thousands of such cases every day.

The ability of Kansas residents to communicate with online lenders while working or traveling out of state creates massive problems for a lender trying to determine whether the KCCC applies to any particular transaction because available technology cannot pinpoint the physical location of the consumer at the time of the loan. As recently explained in *ACLU v. Gonzales*, "IP intelligence services" are only able to "determine, within a 20 to 30 mile radius, the location from which a user is accessing a Web site," and if a user is accessing a Web site through AOL, it is only possible to "determine whether the person is on the East or West Coast of the United States." 478 F. Supp. 2d 775, 807 (E.D. Pa. 2007).[30] And even that generalized location information does not come cheap; it can cost as much as $500,000 per year. *Id.*

Faced with a statute that fails to define "solicitation" and unable reliably to verify an applicant's physical location at the time of the "solicitation," online

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[30] *See also* Information Technology Association of America, *Ecommerce Taxation and the Limits of Geolocation Tools* (2002), *available at* http://www.itaa.org/taxfinance/docs/geolocationpaper.pdf.

lenders approached by Kansas residents cannot practicably determine when they are subject to Kansas's regulatory regime. And yet they face millions of dollars in fines if they fail to comply. That risk of financial ruin imposes a powerful chilling effect on interstate commerce. As a practical matter, most online lenders will be forced to use Kansas residence as a proxy for physical location and either (1) apply Kansas law to all loan applications listing a Kansas address regardless of where the borrower is physically located, or (2) refuse to lend to Kansas residents altogether. Either way, as a practical matter, the KCCC *will* apply to consumer credit transactions "wholly outside" of Kansas.

The district court never grappled with this reality. Instead, it relied on *A.S. Goldmen & Co. v. N.J. Bureau of Sec.*, 163 F.3d 780 (3d Cir. 1999), and related cases to conclude that "plaintiff's entering into loan contracts specifically with Kansas citizens does not represent conduct occurring wholly outside Kansas." *Quik Payday*, 509 F. Supp. 2d at 982. But that misconstrues the case law by conflating residency with physical location at the time of the indeterminate "solicitation." The cited cases stand only for the proposition that when elements of a contract *take place* in two different states (*e.g.,* an offer in one and acceptance in another) each state can regulate the local component of the transaction without running afoul of the Commerce Clause. *A.S. Goldmen*, 163 F.3d at 787, 789 n.16 (holding that "[a] contract between Goldmen *in New Jersey* and a buyer *in New*

York does not occur 'wholly outside' New Jersey," and distinguishing cases where the "offer and acceptance took place entirely outside of" the regulating state) (emphasis added); *Cambridge Credit Counseling Corp. v. Foulston*, 303 F. Supp. 2d 1188, 1196 (D. Kan. 2003), *vacated by* No. 03-3317, 2004 WL 3266802 (10th Cir. Oct. 19, 2004) (emphasizing that "plaintiff's Kansas clients conduct all their business transactions with the plaintiff while remaining in the state of Kansas" and "without ever leaving Kansas"); *People v. Fairfax Family Fund, Inc.*, 235 Cal. App. 2d 881, 885 (Cal. App. Ct. 1964) (loan negotiations took place in regulating state).

The case law makes clear that simply entering into a loan contract "with Kansas citizens" does not give the state *carte blanche* to impose its regulatory regime on out-of-state transactions. As the Seventh Circuit held in *Dean Foods Co. v. Brancel*, 187 F.3d 609, 619-20 (7th Cir. 1999), specifically distinguishing *A.S. Goldmen*, "the fact that a particular transaction may affect or impact a state does not license that state to regulate commerce which occurs outside of its jurisdiction." *See also Stroman Realty, Inc. v. Antt*, Civ. No. H-98-283, 2005 U.S. Dist. LEXIS 16048, at *31 (S.D. Tex. July 28, 2005) (state could "not disrupt the opportunity of its citizens to seek the services they need from people in other states"); *cf. Allstate Ins. Co. v. Hague*, 449 U.S. 302, 310-11 (1981) ("nominal residence—standing alone—[is] inadequate" in due process context); *Bigelow v.*

Virginia, 421 U.S. 809, 824 (1975) ("A State does not acquire power or supervision over the internal affairs of another State merely because the welfare and health of its own citizens may be affected when they travel to that State.").

In sum, the indeterminacy of the Kansas statute and the difficulty of ascertaining physical location on the internet will force out-of-state lenders to comply with Kansas law in out-of-state transactions, in violation of the Commerce Clause. *See Knoll Pharm. Co. v. Sherman*, 57 F. Supp. 2d 615, 623-24 (N.D. Ill. 1999) (dormant Commerce Clause violation even where state statute did not "facially attempt to control actions outside Illinois"); *In re Vonage Holdings Corp.*, 19 F.C.C.R. 22,404 at ¶ 39 (2004) (Because location of DigitalVoice users on the internet "cannot practically be determined," company would be required to comply with Minnesota regulations for *all* uses, leading to impermissible "'practical effect' of regulating beyond [state] borders"). Intentional or not, the Kansas statute works precisely the end feared in *Healy*, *Knoll*, and *Vonage* and cannot withstand constitutional scrutiny.

III. ENFORCEMENT OF STATUTES LIKE THE KCCC WILL IMPERMISSIBLY SUBJECT OUT-OF-STATE ONLINE LOAN TRANSACTIONS TO INCONSISTENT STATE REGULATIONS

A state law is invalid under the Commerce Clause if it "adversely affect[s] interstate commerce by subjecting activities to inconsistent regulations." *CTS Corp. v. Dynamics Corp. of Am.,* 481 U.S. 69, 88 (1987). A court must examine

"how the challenged statute may interact with the legitimate regulatory regimes of other States and *what effect would arise if not one, but many or every, State adopted similar legislation*." *Healy*, 491 U.S. at 336 (emphasis added). If applying the KCCC to online payday loans by out-of-state lenders would impose multiple and inconsistent state regulations on a single loan transaction, the KCCC cannot stand.

The district court understood this principle but misapplied the facts. It erroneously concluded—despite contrary evidence—that "Plaintiff and other internet payday lenders are not in danger of having inconsistent regulations from several states apply to the same transaction." *Quik Payday*, 509 F. Supp. 2d at 984. That is not so.

Unless the online lender is itself a Kansas business, *every loan transaction* the lender enters into over the internet with a Kansas resident may be subject to the differing and potentially conflicting regulatory regimes of at least two states, those of Kansas and the lender's home state. Kansas will claim regulatory jurisdiction whenever the borrower is solicited in Kansas (or, for some purposes, whenever the consumer is a Kansas resident, *supra* at 17 n.29). And, if the lender's home state has adopted jurisdictional provisions comparable to Kansas's, it will claim regulatory jurisdiction of the same transaction upon the lender's receipt of a signed writing evidencing the loan. §16a-1-201(1)(a).

This is not merely a hypothetical problem. Most states regulate lenders operating within their borders.[31] Others, like Kansas, also regulate loans entered into with their residents.[32] And, still others apply their consumer credit laws to in-state consumers[33] or any transaction "bearing an appropriate relation to th[e] state."[34] Indeed, based on vagaries inherent in the territorial reach of the fifty states' consumer credit laws, a single internet loan transaction could be subject to the varying laws of *three* states—*e.g.,* a Kansas consumer could enter into a loan transaction with an Oklahoma lender from his Missouri office.

The problems of applying multiple state regulations to each loan are as diverse as the regulations themselves. States regulate the payday lending industry in minute detail, and a single loan transaction that falls within the regulatory reach of two (or more) states will almost certainly face inconsistent requirements. For example, payday loan agreements sometimes contain "work-out provisions" that mandate debt restructuring. Some states *require* such provisions to kick-in after a certain number of rollovers, Okla. Stat. tit. 59, §3109(D), while others *prohibit* them, Neb. Rev. Stat. §45-919(f). Thus, a creditor could face a binding

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[31] *See, e.g.*, Okla. Stat. tit. 14A, §1-201(1)(c); 7 Pa. Stat. Ann. §6203; R.I. Gen. Laws §19-14-2; La. Rev. Stat. Ann. §§9:3557, 9:3560(A).

[32] *See, e.g.*, Ariz. Rev. Stat. §6-1251.

[33] 815 Ill. Comp. Stat. Ann. 122/1-15.

[34] Mo. Rev. Stat. §400.1-105(1); *see also* Minn. Stat. §336.1-301.

requirement from one state to conduct a workout, while being enjoined from doing so by the other.

For this reason too, Kansas's regulations cannot survive Commerce Clause scrutiny. *See Stroman*, 2005 U.S. Dist. LEXIS 16048, at *20 (holding that "the risk of inconsistent requirements for a single transaction or a single broker would . . . make [the provisions regulating out-of-state brokers] impermissible"); *NCAA v. Miller*, 10 F.3d 633, 639-40 (9th Cir. 1993) (invalidating Nevada law prescribing procedural rules for NCAA enforcement proceedings where other states had passed statutes that "could easily subject the NCAA to conflicting requirements" and presented a "serious risk of inconsistent obligations").

IV. THE DISTRICT COURT ERRED IN CONCLUDING THAT THE KCCC DOES NOT IMPOSE A BURDEN ON INTERSTATE COMMERCE EXCESSIVE RELATIVE TO ITS MARGINAL LOCAL BENEFITS

Applied to online payday lenders, the Kansas statute also fails Commerce Clause scrutiny because the "burden imposed on such commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). The district court rejected this argument based on an overly broad reading of *Aldens* and an unduly cramped understanding of *Johnson*.

Almost thirty years ago, this Court held that when an Illinois mail order house solicited business in Oklahoma by mailing catalogues and goods to Oklahoma residents, the admitted burden (and cost) of having to comply with

Oklahoma's interest rate limitations did not constitute an undue burden under the Commerce Clause. 571 F.2d 1159. Although superficially similar, *Aldens* does not control the present case.[35] In stark contrast to the online lending industry, the mail order business revolves around a tangible and clear location: the location to which the mail (and later the tangible goods) are sent. But, as this Court recognized more recently in *Johnson*, geographic location is not a useful concept when applied to internet communication. 194 F.3d at 1161. This is not a question of "[p]inpointing a specific location within the state" or identifying a "consumer's very discrete address," as the district court presumed, *Quik Payday*, 509 F. Supp. 2d at 980 n.6; it is a matter of being unable to "pinpoint" physical location (not residence) to ascertain *which* state a prospective borrower is in at the time of "solicitation."[36] This technical difficulty inherent in internet transactions was simply non-existent in *Aldens*.

The district court also committed other errors apart from its reliance on *Aldens*. On the benefits side, the court accepted Kansas's purported state interest

[35] *Aldens* does not speak to the extraterritorial application of state law or the significant risks of inconsistent regulations. *See* Sections II & III, *supra*. Indeed, the foundational cases for these doctrinal analyses (such as *Healy* and *Brown*) were not decided until several years later.

[36] Nor is the district court's implicit reliance on TILA apposite. TILA does not preempt state laws setting interest rate limitations, but it also does not specify *which* state can apply its usury laws to a given transaction or have any bearing on the multitude of other regulations that Kansas seeks to apply to out-of-state online lenders.

at face value, contrary to controlling case law. Protecting Kansas consumers is, of course, a legitimate local interest. But, "the mere 'incantation of a [legitimate] purpose . . . does not insulate a state law from Commerce Clause attack.'" *Blue Circle Cement*, 27 F.3d at 1512 (citation omitted); *see also Hunt v. Washington State Apple Adver. Comm'n*, 432 U.S. 333, 350 (1977) ("[A] finding that state legislation furthers matters of legitimate local concern, even in the health and consumer protection areas, does not end the inquiry."); *S. Pac. Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 779-80 (1945) (Commerce Clause scrutiny cannot be avoided " by 'simply invoking the convenient apologetics of the police power'") (citation omitted); *Stroman*, 2005 U.S. Dist. LEXIS 16048, at *18 ("[D]escribing [a] regulatory scheme[] for businesses as consumer protection does not mean that consumers are benefited in the actual operation or that an illegal end is not accomplished."). Where a statute is not fairly calculated to achieve its putative ends, the weight of the local interest in *Pike*'s calculus concomitantly declines. *See MITE Corp.*, 457 U.S. at 644 (discounting local benefits); *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 178 (S.D.N.Y. 1997).

The district court failed to "scrutinize" the nature of the putative local benefit. *Blue Circle Cement*, 27 F.3d at 1512. Just as Kansas has a legitimate interest in protecting its consumers from fraud and overreaching creditors, New Mexico undoubtedly had an equally (if not more) compelling interest in protecting

minors from viewing sexually-oriented material. Nevertheless, the *Johnson* Court found the "local benefits of the regulation . . . not especially great," *Quik Payday*, 509 F. Supp. 2d at 980, because, *inter alia*, the statute at issue "particularly as narrowly construed by defendants" could "'have no effect on communications originating outside the United States.'" 194 F.3d at 1162 (citation omitted). The district court ignored the fact that the KCCC is hampered by the very same limitation.

Kansas's regime for regulating payday loans is notably porous. Kansas consumers can readily access payday loans from storefront operations in bordering states or from offshore online payday lenders that are equally beyond the state's regulatory control. Already two of the largest online lenders (neither of which are OLA members) operate offshore. If the single-state-regulation model proves infeasible, more will follow. A regulatory scheme that succeeds merely in driving internet lenders offshore produces no substantial local benefits, and indeed would have the perverse consequence of diminishing effective governmental oversight of payday lending and driving out competition in the consumer credit market—to the distinct detriment of Kansas consumers.

The interests of the borrower's state of residence are further diminished because most lenders, like Quik Payday, are already regulated by their home state. In other words, this is not an all or nothing proposition. Just as California and

Florida did not need to independently protect their citizens against out-of-state real estate brokers in *Stroman* because "[t]he states and their consumers have a Texas forum for claims under Texas law or theirs," 2005 U.S. Dist. LEXIS 16048, at *27, Kansas does not need to pile on additional protections because its citizens already have a Utah forum.

As for burdens, the district court erred by focusing exclusively on the licensure requirement and ignoring the litany of other onerous regulations imposed by Kansas, not to mention the minefield of inconsistent and conflicting regulations imposed by other states. As OLA explained in the district court, the financial and administrative burden of navigating a myriad of "competing and interlocking local economic regulation[s]," *Healy*, 491 U.S. at 337, in 50 different states would be crushing. *Cf. Stroman*, 2005 U.S. Dist. LEXIS 16048, at *20 (holding that even when the state schemes were "substantially similar," having to "comply with 50 sets of rules" was a "non-trivial administrative burden"). Even where there is no direct conflict among the various regulations, simply complying with a vast multitude of widely varying requirements would impose debilitating costs on these low-margin businesses.[37] *Cf.* Robert C. Eager & C.F. Muckenfuss, III, *Federal*

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[37] Added to the general costs of compliance that come with having to decipher and comply with 50 different state laws, in Kansas an online lender must also endure the extra burden of verifying where, when, or even if a "solicitation" has occurred. Even if verifying physical location at the time of solicitation is possible, it is at the very least inordinately burdensome. *See* Section II, *supra*.

Preemption and the Challenge to Maintain Balance in the Dual Banking System, 8 N.C. Banking Inst. 21, 30 (2004) (observing that "'laws regulating loan terms, imposing conditions on lending and deposit relationships, and requiring state licenses . . . create higher costs and operational burdens that the banks either must shoulder, or pass on to consumers, or that may have the practical effect of driving them out of certain businesses'") (citation omitted).

For example, a lender attempting to comply with the laws of Kansas, Montana and Illinois (*e.g.*, on an internet loan by a Montana lender to a Kansas borrower attending the University of Chicago) would face daunting compliance costs. *See generally* Kan. Stat. Ann. §16a-2-404 *et seq.*; Mont. Code Ann. §31-1-701 *et seq.*; 815 Ill. Comp. Stat. Ann. 122/1-1 *et seq*. It would have to look to Kansas law for the maximum interest rate (15%). Montana law would then set the maximum loan amount ($300), unless the borrower made less than $1200 per month, in which case Illinois law would set a lower maximum amount. Illinois would dictate the minimum term (13 days) and Kansas the maximum term (30 days) of the loan. If the borrower were unable to pay off the loan at maturity, Kansas law would set a 3% monthly percentage rate limit; however, once the loan was 35 days old, Illinois law would require a repayment plan whereby the loan could be repaid in installments over a period of up to 55 days with no charges. The combination of potential requirements among the 50 states is astronomical, *see*

Appellant's Appx. 93-102, and because the lending regulations are all subject to change and administrative interpretation, the lender could not rely on any static chart to navigate these waters. And, when one of the two (or three) states prohibits payday lending altogether, the consequences of a wrong turn could be severe.

It is well recognized that the economic inefficiency and added expense of burdensome state regulations can, from a constitutional standpoint, dwarf their local benefits. *See MITE Corp.*, 457 U.S. at 643; *Kassel v. Consol. Freightways Corp.*, 450 U.S. 662, 674 (1981); *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 529-30 (1959). Kansas's expansive statute creates a web of costly and inefficient regulatory burdens in contravention of the Commerce Clause.

CONCLUSION

State regulators' desire to "protect" their residents through expansive regulatory regimes reaching far beyond state lines is not limited to payday lenders or to Kansas. If the district court's decision is allowed to stand, it will not only harm the online payday loan industry but also embolden regulators to push the territorial limits on their authority even further, with dire consequences for competition, the internet, and interstate markets, and to the distinct detriment of consumers. The dormant Commerce Clause exists to protect against such overreaching and, for all the foregoing reasons, the district court's decision should be reversed.

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CERTIFICATE OF COMPLIANCE WITH RULE 32

I hereby certify in accordance with Fed. R. App. P. 32(a)(7)(C) that this brief has been prepared within the type-volume limitations of Fed. R. App. P. 32(a)(7)(B), and this brief contains 6,971 words, excluding the parts exempted by Fed. R. App. P. 37(a)(7)(B)(iii).

I hereby certify that this brief complies with the typeface requirements of 10th Circuit Rule 32(a) because this brief was prepared using Microsoft Word 2003 in 14-point Times New Roman font.

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CERTIFICATION OF DIGITAL SUBMISSIONS

I, Richard P. Bress, hereby certify that:

(1) there were no privacy redactions to be made in the documents submitted on December 20, 2007, and every document submitted in Digital Form is an exact copy of the written document that was sent to the Clerk; and

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