No. 07-3289

IN THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

QUIK PAYDAY, INC., d/b/a QUIK PAYDAY.COM, QUIK PAYDAY.COM FINANCIAL SOLUTIONS ONLINE, WWW.QUIKPAYDAY.COM, QUIK PAYDAY,

Plaintiff/Appellant,

v.

JUDI M. STORK, in her official capacity as Acting Bank Commissioner and KEVIN C. GLENDENING, in his official capacity at Deputy Commissioner of the OFFICE OF THE STATE BANK COMMISSIONER, STATE OF KANSAS,

Defendants/Appellees.

On Appeal from the United States District Court
For the District of Kansas
The Honorable Judge John W. Lungstrum
D.C. No. 2:06-cv-2203

APPELLANT QUIK PAYDAY'S REPLY BRIEF

BRYAN CAVE LLP
Robert J. Hoffman KS #16453
Jeremiah J. Morgan KS #19096
1200 Main Street, Suite 3500
Kansas City, Missouri 64105-2100
Telephone: (816) 374-3200
Facsimile: (816) 374-3300

DUANE MORRIS LLP
Daniel V. Folt DE #3143
Matt Neiderman DE #4018
1100 North Market Street, Suite 1200
Wilmington, DE 19801-1246
Telephone: (302) 657-4900
Facsimile: (302) 657-4901

Oral Argument is requested.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Page**

Statutes and Other Authority **Page**

INTRODUCTION[1]

To understand why Defendants' arguments fail, one need only read their assertion that: "Regulating the Internet is not the issue in the instant case. The issue is whether or not individual states can continue to regulate consumer loans with its [sic] own citizens." *See* Appellees' Brief at 12. Defendants seem to believe that Kansas' regulations always attach to the state's citizens, even when they choose to conduct commerce in other states. That is most definitely not the law.

In fact, this case is about Internet commerce and only Internet commerce. Kansas citizens have always had the right to drive across state lines and take out loans from other states' lenders, free of Kansas law. That right is guaranteed by the dormant Commerce Clause to the U.S. Constitution, as confirmed through more than a century of Supreme Court jurisprudence. *See, e.g., Healy v. Beer Inst.*, 491 U.S. 324, 337 (1989) ("no State may force an out-of-state merchant to seek regulatory approval in one State before undertaking a transaction in another"); *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 526 (1996) (Thomas, J. concur.) ("When a State seeks to dampen consumption by its citizens of products or services outside its borders, it does not have the option of direct regulation.")

---

[1] Capitalized terms retain the definitions set forth in Quik Payday's opening brief.

The issue presented by this appeal, then, is whether the advent of the Internet empowers Defendants to do something that constitutionally they were never able to do before – namely, regulate an out-of-state lender. That is because in 1999, Kansas amended its Consumer Credit Code – in response to "concern over the growing use of the Internet" – to expressly cover Internet transactions between out-of-state lenders and persons claiming Kansas residence – regardless of where those transactions actually take place. *See* 2000 Comment to Kan. Stat. Ann. § 16a-1-201 (Aplt. App. 281-82). In other words, the issue is not, as Defendants maintain, whether an Internet presence should "exempt Quik Payday from the same laws to which every other payday lender must adhere" (*see* Appellees' Brief at 13, emphasis added), but rather whether an Internet presence should subject Quik Payday to laws which no other out-of-state lender must adhere.

The answer to this question is critical to the future of Internet commerce. If every state is permitted to regulate Internet commerce as aggressively as Kansas has done, there eventually will be little business left to regulate. Yet, despite its relative newness, the subject matter of this lawsuit is not *terra incognita*. Rather, this Court, in its seminal decision in *ACLU v. Johnson*, 194 F.3d 1149 (10th Cir. 1999), has already held that these sorts of state regulatory incursions into the Internet unconstitutionally burden interstate commerce. As explained below, the reasoning of *Johnson* squarely applies here. Accordingly, the decision below

should be reversed, and the District Court should be directed to enter judgment in favor of Quik Payday on its dormant Commerce Clause claim.

ARGUMENT

I. DEFENDANTS' ARGUMENTS DO NOT SATISFY THE NATIONAL UNITY TEST.

Defendants premise their assertion that Kansas has the right to regulate Internet payday lending on the Federal Truth In Lending Act, which allows the states to set a maximum interest rate on consumer loans. Defendants also argue that the District Court "correctly relied on *Ford Motor Co. v. Texas Dept. of Transportation* because following Quik Payday's reasoning results in overriding Congress's clear intent to allow states to regulate payday loans." *See* Appellees' Brief at 32. Finally, Defendants contend that the District Court properly interpreted *Johnson* as regulating only Internet content.

In *Johnson*, this Court ruled that, under the national unity test, a law violates the dormant Commerce Clause if "it subjects interstate use of the Internet to inconsistent state regulation." 194 F.3d at 1161. The 1999 Amendment does just that; indeed, neither side disputes it. To the contrary, Defendants spend much of their brief extolling the "substantial differences between how Kansas and Utah choose to regulate payday loans." *See* Appellees' Brief at 13.

Yet, Defendants argue that *Johnson* is irrelevant. In the decision below, the District Court strangely found – contrary to the stipulated facts – that Quik Payday

had not proven that its loans were subject to Utah regulation, and thus that adding Kansas law on top of that would not lead to inconsistent state regulation. (Aplt. App. 509). Defendants do not even try to defend this ruling, admitting in their brief that Quik Payday is "licensed by the state of Utah." *See* Appellees' Brief at 5.

Instead, Defendants take a different tack. They argue that this Court's exposition of the dormant Commerce Clause in *Johnson* protects Internet pornographers, but not Internet lenders. This would seem counterintuitive, as lending is a far more commercial endeavor than pornography, and states have a far greater regulatory interest in protecting children from illicit materials than in "protecting" adults from online commercial lending. As Defendants explain it, the crucial difference is that Quik Payday "*chose* to make a payday loan with a Kansas consumer." *See* Appellees' Brief at 6, emphasis added.

This "distinction" is illusory. Quik Payday did not "choose" Kansas residents; it offered loans to residents of all fifty states. What Defendants are trying to say is that Quik Payday asked applicants on its web site to list their address, unlike pornography web sites which grant their users anonymity. By Defendants' logic, Quik Payday should be punished for asking the question, stripped of a constitutional right afforded even to Internet pornographers. And to restore its constitutional rights, it need only stop asking.

Quik Payday respectfully submits there is nothing in *Johnson* which would suggest that the dormant Commerce Clause should be read so narrowly. Rather, Defendants appear to be confusing the other half of the *Johnson* decision, addressing First Amendment rights, with the half of the decision at issue here, analyzing the dormant Commerce Clause. That latter analysis is commerce-based, not content-based. Indeed, several commercial cases have expressly relied on *Johnson's* Commerce Clause analysis, including *In re Vonage Holdings Corp*, 19 F.C.C.R. 22404, 22430 (Nov. 12, 2004), a case involving Internet-based telephone service, and *Stroman Realty Inc. v. Antt*, 2005 U.S. Dist. Lexis 16048, *18 (S.D. Tex., July 28, 2005), involving Internet timeshare sales.

Defendants instead offer up a red herring – the federal Truth in Lending Act, 15 U.S.C. § 1610(b), which allows states to set interest rates applicable to consumer loans, to support its claim that it should be able to impose its entire licensing regime on Quik Payday. This is really beside the point. Quik Payday has never claimed that it is exempt from all state regulation. As noted above, Quik Payday is a licensed Utah-lender. That has never been at issue. Rather, the issue here is whether Kansas can add its own layer of inconsistent state regulations on top of Utah's, simply because the loans are made over the Internet. The Truth in Lending Act contains no such congressional grant.

As the Supreme Court has held: "Congress must manifest its unambiguous

intent before a federal statute will be read to permit or to approve ... a violation of the Commerce Clause." *Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992) (emphasis added). For "a state regulation to be removed from the reach of the dormant Commerce Clause, congressional intent must be unmistakably clear. The requirement that Congress affirmatively contemplate otherwise invalid state legislation is mandated by the policies underlying dormant Commerce Clause doctrine." *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 91-92 (1984) (emphasis added). Here, there is no evidence that Congress intended to authorize states like Kansas to regulate other states' Internet lenders.

Defendants also argue that the District Court "correctly relied on *Ford Motor Co. v. Texas Dept. of Transportation* because following Quik Payday's reasoning results in overriding Congress's clear intent to allow states to regulate payday loans." *See* Appellees' Brief at 32. It is unclear what this statement means, since the *Ford Motor* case has nothing to do with the Truth in Lending Act, but rather with a Texas regulation which restricted Ford's ability to advertise on its web site. The Fifth Circuit found that the regulation was only "incidental to [Texas'] prohibition on Ford's right to engage in the economic activity of retailing automobiles." 264 F.3d at 506. By contrast, Internet regulation is anything but "incidental" to the 1999 Amendment. As noted above, it is the very purpose of that statute. Moreover, the Summary Order that Kansas imposed on Quik Payday

is directed solely to Quik Payday's Internet activities.

Defendants also assert that, if Quik Payday prevailed on its national unity arguments, "Utah would dictate consumer lending laws to every state in the Union." *See* Appellees' Brief at 12. The reality is just the opposite. Prior to the 1999 Amendment, Kansas only regulated Kansas lenders, and left Utah lenders to Utah authorities. Invalidating the 1999 Amendment would restore the pre-Internet world in which each state regulated the loans made in its own state. Here, Defendants concede that: "Quik Payday's office, employees, and loan records were in Utah, not in Kansas, so the payday loan applications, contracts, and loan payments were received by Quik Payday in Utah." *See* Appellees' Brief at 8. Utah, not Kansas (and certainly not both Utah and Kansas), is the right state to be regulating these loans.

II. DEFENDANTS' ARGUMENTS DO NOT SATISFY THE *PIKE* BALANCING TEST.

In *Johnson*, this Court ruled that, under the *Pike* balancing test, a law violates the dormant Commerce Clause if: "it constitutes an unreasonable and undue burden on interstate and foreign commerce…." 194 F.3d at 1161 (citing *Pike v. Bruce Church, Inc*., 397 U.S. 137, 142 (1970)). The *Pike* test requires "a two-fold inquiry. The first level of examination is directed at the legitimacy of the state's interest. The next, and more difficult, determination weighs the burden on

interstate commerce in light of the local benefit derived from the statute." *Am. Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 177 (S.D.N.Y. 1997).

In order for the 1999 Amendment to pass Constitutional muster, Defendants must show that Kansas has a legitimate interest in reaching beyond its borders and regulating lenders duly licensed and operating in other states. For the most part, however, Defendants resort to *ad hominem* attacks, calling short-term consumer loans "the bailiwick of underworld loan sharks and racketeers."[2] The undisputed evidence here, however, is that Quik Payday had a near-spotless record in lending to persons listing Kansas addresses. "From May 2001 to January 2005 Quik Payday made 3079 payday loans to 972 consumers who listed Kansas addresses on their loan applications." Appellees' Brief at 3. Yet from these more than three thousand loans, Defendants have identified only one consumer complaint. *Id.* at 9. Defendants do not contend that this single complaint, received on June 15, 2005, was substantial, material or in any way meritorious, yet that has not stopped them from fining Quik Payday $5 million and banning the company from making any further loans to persons claiming Kansas residence.

---

[2] Despite Defendants' implications, yet another recent study has found that the availability of payday loans, when all other factors are fixed, increases "the probability of financial survival by 31%. Payday loans, therefore, are a means for the subjects to absorb shocks when, for example, they do not sufficiently save for the unexpected 'rainy days.'" Bart J. Wilson et al., *An Experimental Analysis of the Demand for Payday Loans*, January 14, 2008, at http://gunston.gmu.edu/bwilson3/papers/PaydayLoans.pdf.

Defendants contend that Kansas has a legitimate interest in regulating lenders duly licensed and operating in other states which exceeds any burden imposed upon interstate commerce. First, they claim that the 1999 Amendment has the goal of "protecting Kansas consumers by vetting the character, honesty, and financial responsibility" of payday lenders, and "enhancing competition among lenders." *See* Appellees' Brief at 16. Next, they contend that the 1999 Amendment does not excessively burden interstate commerce, returning to their oft-repeated mantra that Quik Payday would only be subjected to a $1,000 fee. Finally, Defendants assert that the 1999 Amendment would not subject Quik Payday to multiple states' regulations.

Defendants claim that the 1999 Amendment benefits consumers by somehow "enhancing competition among lenders by encouraging banks, credit unions and other presumably reputable well-funded sources of consumer credit to enter markets they have traditionally avoided." *See* Appellees' Brief at 16. But Defendants never explain how forcing out-of-state lenders to comply with two conflicting sets of state regulations on each loan will "encourage" such lenders to enter the market for small, short-term loans that Quik Payday services. As a matter of basic logic, it would have the exact opposite effect.

Defendants also argue that Kansas must impose its own regulations on Quik Payday, a licensed Utah lender, because "Utah's regulations … employ a laissez-

faire approach to payday loan regulation." *See* Appellees' Brief at 10. As evidence of this "laissez-faire approach," Defendants cite to the supposed fact that Utah, unlike Kansas, "does not run a criminal background check on principals of businesses prior to allowing them to make consumer credit loans… [and] does not check the financial situation of any of its applicants prior to allowing them to make loans." *Id.* at 10-11. These statements are simply untrue.

In reality, Utah actually not only performs a background check, but requires disclosure of more information than would be revealed by a criminal background check. Specifically, the Utah Code requires that the Commissioner:

> [C]ause the appropriate supervisor to make a careful investigation and examination of the following:
>
> (i) the character, reputation, and financial standing and ability of the organizers;
>
> (ii) the character, financial responsibility, experience, and business qualifications of those proposed as officers;
>
> (iii) the character and standing in the community of those proposed as directors, principal stockholders, or owners;
>
> (iv) the need in the service area where the institution would be located, giving particular consideration to the adequacy of existing financial facilities and the effect the proposed institution would have on existing institutions in the area;
>
> (v) the ability of the proposed service area to support the proposed institution, including the extent and nature of existing competition, the economic history and future prospects of the community, and the opportunity for profitable employment of financial institution funds; and
>
> (vi) other facts and circumstances bearing on the proposed institution that the supervisor considers relevant.

Utah Code Ann. § 7-1-704.

Moreover, *Pike* looks to the alleged benefits of the regulation as applied in the particular case. *See Pike,* 397 U.S. at 144. In this case, a $5 million fine based on a single, unproven, undisclosed and seemingly unmeritorious complaint is a burden that clearly exceeds any benefit provided to Kansans.

As for the burden side of the *Pike* balancing test, the theme of Defendants' brief is that the only burden on Quik Payday to comply with Kansas law is an insubstantial $1,000 annually. This argument ignores entirely the substantial regulatory burden that would be imposed on Quik Payday if the KCCC applies to out-of-state lenders. In its brief, Kansas failed to respond to cases cited by Quik Payday holding that the Court must, in performing the *Pike* balancing test, look not only at the monetary burden imposed on a lender, but must also look at the regulatory burden imposed by the state on that lender. As the Supreme Court explained in *Morgan v. Virginia*, 328 U.S. 373, 380 (1946), in the context of the railroads: "Burdens upon commerce are those actions of a state which directly impair the usefulness of its facilities for such traffic. That impairment, we think, may arise from other causes than costs ...." (Citation omitted).

Defendants also rely heavily on the *Aldens* cases, a series of pre-Internet mail-order catalog cases from the 1970s. The applicability of these cases to Internet commerce is questionable. In any event, as to *Pike* balancing, the *Aldens*

cases stand for a simple proposition: in the context of interest rates applicable to a particular transaction, the mail order company can simply use the lower of the two interest rates. The *Aldens* cases in no way address the situation present here, where two states are attempting to impose conflicting and contradictory full-scale regulatory regimes – not just different interest rates – on the same transaction.

Defendants also repeat the District Court's contention that such regulatory burdens are not evidence. But this Court is free to take judicial notice of the various state regulations and the manner in which they conflict with each other. *See United States v. Williams*, 442 F.3d 1259, 1261 (10th Cir. 2006) ("That the courts are allowed to take judicial notice of statutes is unquestionable.") (quoting *United States v. Coffman*, 638 F.2d 192, 194 (10th Cir. 1980)).

Even a cursory examination of the fifty states' regulations – which were detailed for the District Court in Table A to Quik Payday's original summary judgment brief (Aplt. App. 92) – demonstrates that Defendants' position would create a morass. If Kansas can regulate Utah lenders, then two or more states can regulate every single interstate loan transaction. As Table A shows, many of these regulations are mutually inconsistent. Yet Defendants do not even try to explain what a lender is supposed to do when it finds itself in such a situation, other than be fined $5 million and banned from the state by overzealous regulators. The whole point of *Johnson* is that Internet commerce is to be free of this sort of

parochialism. There is no cause to roll back that decision here.

III. DEFENDANTS' ARGUMENTS DO NOT SATISFY THE EXTRATERRITORIALITY TEST.

In *Johnson*, this Court ruled that, under the extraterritoriality test, a law violates the dormant Commerce Clause if "it regulates conduct occurring wholly outside of the state…." 194 F.3d at 1161. The 1999 Amendment as applied to Quik Payday violates this test, since it is keyed toward the address the applicant lists on his or her application, not the actual physical location of the applicant when he or she is making the loan. Particularly in a state like Kansas, where so many persons work across state lines, they are not necessarily the same.

Lastly, Defendants try to circumvent Quik Payday's arguments by distorting the stipulated facts and by asserting that the Kansas consumers' performance of their contracts with Quik Payday occurred in Kansas. Thus, Defendants argue, Kansas has the right to regulate Quik Payday's loans.

To maneuver around this fact, Defendants employ some circular reasoning; namely, that the 1999 Amendment only applies to Kansas transactions because "in order for the Kansas UCCC to apply, solicitation has to occur within Kansas." Appellees' Brief at 25. This glosses over the realities of the statute. Prior to 1999, Kansas' UCCC applied only to consumer credit transactions "made in this state." Kan. Stat. Ann. § 16a-1-201. In that year, however, the Legislature expanded the

words "in this state" to include transactions outside the state where "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 ... electronic means." Kan. Stat. Ann. § 16a-1-201(1)(b). Defendants, however, admit they determine where a "solicitation" was made solely based on the address listed on the loan application: "The sole focus of [Defendants'] regulatory efforts is with lenders … who choose to transact payday loans with Kansas citizens." *See* Appellees' Brief at 26.

In short, Defendants are simply assuming the facts they should be demonstrating – that the fined solicitations occurred in Kansas. There is simply no evidence in the record as to where the consumers at issue were solicited or where they filled out their applications. Defendants simply cannot justify imposing a $5 million fine, disgorgement of all fees collected over a four-year period and an outright ban of Quik Payday from lending in the state based on a mere assumption that parts of the loan application process occurred in Kansas.

Defendants try to bolster their assumption by mischaracterizing the record. They claim that [t]he stipulated facts show that Kansas consumers' performance of the contract occurred while in Kansas." Appellees' Brief at 35. No such facts were stipulated in the record. The stipulated facts set forth the typical application process required to obtain a loan from Quik Payday, but do not mention where any particular consumer was when they performed any step of that process. (Aplt.

App. 58-59). Because of the nature of the Internet, it is not possible for Quik Payday, or any other online lender, to determine the physical location of the applicant when he or she accesses Quik Payday's website and fills out an online application. For Kansas to contend otherwise is fallacious.

CONCLUSION

For all the foregoing reasons, and the reasons set forth in Quik Payday's opening brief, the decision below should be reversed, and the District Court directed to enter Summary Judgment in Quik Payday's favor.

Respectfully Submitted,

BRYAN CAVE LLP

/s/ Jeremiah J. Morgan
Robert J. Hoffman KS #16453
Jeremiah J. Morgan KS #19096
1200 Main Street, Suite 3500
Kansas City, Missouri 64105-2100
Telephone: (816) 374-3200
Facsimile: (816) 374-3300

DUANE MORRIS LLP
Daniel V. Folt (DE #3143)
Matt Neiderman (DE #4018)
Aimee M. Czachorowski (DE #4670)
1100 North Market Street, Suite 1200
Wilmington, DE 19801-1246
Telephone: (302) 657-4900
Facsimile: (302) 657-4901

-and-

John Dellaportas (JD-5427)
1540 Broadway
New York, NY 10036
Telephone: (302) 692-1000
Facsimile: (302) 657-1020

Attorneys for Quik Payday, Inc.

CERTIFICATE OF SERVICE

I hereby certify that on February 8, 2008, I mailed a copy of Appellant Quik Payday's Reply Brief to the following:

Jacob McElwee
Danny J. Vopat
Office of the State Bank Commissioner.
700 SW Jackson St.
Topeka, Kansas 66603

Timothy B. Mustaine
Fouston Siefkin LLP – Wichita
1551 N. Waterfront Parkway
Suite 100
Wichita, Kansas 67206-4466

/s/ Jeremiah J. Morgan
Jeremiah J. Morgan

CERTIFICATE OF COMPLIANCE

I hereby certify, pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, that the Reply Brief for Quik Payday, Inc. in the above-captioned case was prepared using Microsoft Word XP, in 14-point Times New Roman font and that it contains 3,365 words from the Introduction through the Conclusion, as determined by the Microsoft Word XP word-counting system.

/s/ Jeremiah J. Morgan
Jeremiah J. Morgan

CERTIFICATE OF DIGITAL SUBMISSION

I hereby certify that all required privacy redactions have been made, and that with the exception of those redactions, every document submitted in digital form or scanned .pdf format is an exact copy of the written document filed with the clerk. The digital submissions have been scanned and are virus free.

/s/ Jeremiah J. Morgan
Jeremiah J. Morgan

DM1\1285378.5