NORTH CAROLINA
NEW HANOVER COUNTY

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
05-CVS-0447

FILED
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NEW HANOVER COUNTY C.S.C.
BY LDS

JAMES P. TORRENCE, SR., and TONYA BURKE, on behalf of themselves and all other persons similarly situated,

Plaintiffs,

v.

NATIONWIDE BUDGET FINANCE, QC HOLDINGS, INC., QC FINANCIAL SERVICES, INC., FINANCIAL SERVICES OF NC, INC. and DON EARLY,

Defendants.

ORDER DENYING MOTION TO COMPEL ARBITRATION

THIS CAUSE CAME ON TO BE HEARD AND WAS HEARD before the undersigned Superior Court Judge in New Hanover County Superior Court on June 28 through July 1, 2011, upon defendants' motion to compel arbitration. Upon hearing testimony of witnesses, oral arguments, review of briefs and the entire record proper, the Court makes the following findings of fact:

FINDINGS OF FACT

A. BACKGROUND AND PROCEDURAL HISTORY.

1. This action was instituted on February 8, 2005 and assigned to this Court by the Chief Justice under Rule 2.1 of the General Rules of Practice May 9, 2005.

2. Proceedings in this case and in *Knox v. First Southern Cash Advance* were stayed during the period January 2006 through September of 2009. During this time the parties in three similar cases pursued appeals to the Court of Appeals and post-remand rulings by this Court.

3. The Court conducted a hearing on June 28, 2011 through July 1, 2011, at which testimony was received and arguments were presented. In addition, the parties submitted exhibits and deposition transcripts in advance of the hearing.

B. PARTIES.

4. Named plaintiff James Torrence is a resident of Mooresville, North Carolina. The 73 year old father of six children lives with his wife in Mooresville, North Carolina. His payday loans were obtained from the Nationwide Budget Finance office in Mooresville, North Carolina beginning in May of 2003 and ending in February of 2004.

5. Named plaintiff Tonya Burke is a resident of Apex, North Carolina. The 42 year old mother of two sons resides with them and her husband in Apex, North Carolina. At the time of her Nationwide Budget Finance payday loans, Ms. Burke lived in Durham as a single mother and was the sole source of support for her two boys. Ms. Burke's payday loans were obtained from the Nationwide Budget Finance office at 2501 University Drive, Durham, North Carolina, beginning in October of 2003 and continuing through January of 2004.

6. "Nationwide Budget Finance" is the name under which payday lending was carried out at roughly 20 North Carolina payday stores. References in this Order to "Nationwide Budget Finance" refer to the activity conducted at stores using that name, rather than a particular entity.

7. Defendant QC Holdings, Inc. ("QC Holdings") is a corporation with its principal place at 2812 W. 47th Ave., Kansas City, Kansas. Since mid-2004 the stock of QC Holdings has been sold to the public, and as a publicly traded company QC Holdings has filed reports at various times with the Securities and Exchange Commission ("SEC").

8. Defendant QC Financial Services, Inc. ("QC Financial Services") is a wholly owned subsidiary of QC Holdings, Inc. with its principal place of business at 2812 W. 47th Ave., Kansas City, Kansas.

9. Defendant Financial Services of North Carolina, Inc. ("Financial Services of North Carolina") is a wholly owned subsidiary of QC Financial Services, Inc. with its principal place of business at 2812 W. 47th Ave., Kansas City, Kansas. Financial Services of North Carolina is the company named in contracts with County Bank of Rehoboth Beach, Delaware, concerning payday lending at Nationwide Budget Finance offices in North Carolina from 2003 through 2005.

10. Defendant Don Early is a resident of Kansas. According to QC

Holdings' 2004 SEC filings, Mr. Early, "our Chairman and Chief Executive Officer, founded our company in 1984 and has 20 years of experience in the retail financial services industry." Mr. Early was the individual who signed the 2003 agreements with County Bank of Rehoboth Beach, Delaware, concerning payday lending at Nationwide Budget Finance offices in North Carolina.

C. PLAINTIFFS' TRANSACTIONS AND CLAIMS.

11. Named plaintiff Torrence received a loan for $350 on May 12, 2003, then renewed it ten times. Mr. Torrence paid a net total of $929.50 for his loans obtained at Nationwide Budget Finance offices, net of all "principal" disbursements. Plaintiffs assert that Mr. Torrence's most favorable total damages claim, which is calculated under the unfair trade practices statutes, is $2,788.50, including treble damages.

12. Named plaintiff Burke received a loan for $150 on October 24, 2003, then renewed it seven times. All of Ms. Burke's loans thereafter were renewals, although in one transaction she increased her loan amount from $150 to $500. Ms. Burke received a total of $650 in cash and paid a total of $150 in principal and $351 in interest, plus $60 in returned item payments. Plaintiffs assert that Ms. Burke's most favorable total damages claim, which is calculated under the Consumer Finance Act, is $561.

13. The plaintiffs filed this action on behalf of all persons who entered into "payday loan" transactions at Nationwide Budget Finance offices in North Carolina at any time after August 31, 2001, in transactions that did *not* purport to involve a national bank as lender. All evidence indicates that payday lending conducted at North Carolina offices doing business under the name Nationwide Budget Finance from September 1, 2001 through on or about March 31, 2003, *did* involve, or purported to involve, a national bank (First National Bank in Brookings, South Dakota) as lender. Accordingly, the class period in the instant case effectively begins on or around April 1, 2003.

14. In "payday loan" transactions, also known as "deferred deposit" check cashing, a customer wrote a post-dated check for a certain amount, such as in Mr. Torrence's case for $413, and received a cash advance of a lesser amount, such as $350. When the check came due (in the case of Mr. Torrence's initial loan, 18 days later), either the check was presented for payment or the customer paid a fee and substituted a new check.

15. Each of the loans procured by the named plaintiffs had triple-digit

interest rates. The annual percentage rate ("APR") was 365% and 547.5% in connection with the first two transactions for Mr. Torrence, and 938.57% and 469.29% in connection with the first two transactions for Ms. Burke.

16. Plaintiffs allege that defendants "engaged in the business of lending" in North Carolina in violation of the Consumer Finance Act, G.S. §§ 53-164 *et seq.* (the "CFA"), and also violated the North Carolina Check Cashing laws, G.S. §§ 53-276 *et seq.*, the unfair trade practices laws, G.S. §§ 75-1.1 and -16, and the North Carolina usury laws, Chapter 24 of the General Statutes.

D. NORTH CAROLINA LAW AND DEFENDANTS' OPERATIONS.

17. "Deferred deposit" check cashing was, prior to 1997, regarded as a form of lending that was subject to the interest rate limits of the CFA and might violate other law. In 1997 the enactment of former G.S. § 53-281, expressly permitted deferred deposit, or "payday," lending, at high annual percentage rate fees. Former G.S. § 53-281 contained a July 31, 2001 expiration date.

18. In 2001 the General Assembly extended the expiration date of former G.S. § 53-281 by one month, until August 31, 2001, then refused to renew or extend the statute or enact any alternative authorization. Legal authority for payday lending within the state of North Carolina thus expired August 31, 2001.

19. By "Urgent Memo" dated July 31, 2001, addressed to "All check-cashing business licensees who are engaged in 'payday lending,'" the North Carolina Commissioner of Banks advised payday lenders that the expiration of G.S. § 53-281 was imminent. Through a subsequent "Urgent Memo" dated August 30, 2001 addressed to "All check-cashing business licensees now engaged in 'payday lending,'" the North Carolina Commissioner of Banks stated that G.S. § 53-281 would expire the next day and further stated: "there is no lawful basis for 'payday lending' without such a law, including 'payday lending' transactions effective by 'agents' or 'facilitators' of out-of-state lending institutions."

20. From September 2001 through March 2003, Nationwide Budget Finance offices in North Carolina operated under a contract between Financial Services of North Carolina and First National Bank in Brookings, South Dakota, for administration, servicing and collection of payday loans stores in North Carolina. Defendants state that during this period, Financial Services of North Carolina was acting as marketing and servicing agent of First National Bank in Brookings.

21. First National Bank in Brookings was the subject of a Consent Order

issued by the Office of the Comptroller of the Currency ("OCC") on January 17, 2003, requiring it to discontinue all involvement with payday lending by March 31, 2003. Agreements dated March 14, 2003, provided that the Nationwide Budget Finance offices in North Carolina would market and collect loans made by County Bank of Rehoboth Beach, Delaware ("County Bank"). The terms of the County Bank agreement called for Financial Services of North Carolina to bear all liability if the payday loans were found to be illegal, and the agreement contained a clause providing that the terms of the agreement were confidential.

E. THE ARBITRATION AGREEMENT.

22. In order to obtain a payday loan at Nationwide Budget Finance locations in North Carolina during and after April of 2003, customers were required to sign form loan agreements prepared by County Bank.

23. The form loan agreement prepared by County Bank is one-page containing an "Agreement to Arbitrate All Disputes" stating as follows:

> AGREEMENT TO ARBITRATE ALL DISPUTES. You and we agree that any and all claims, disputes or controversies between you and us and/or the Company, any claim by either of us against the other or the Company (or the employees, officers, directors, agents or assigns of the other or the Company) and any claim arising from or relating to your application for this loan, or any other loan you previously, now or may later obtain from us, this Loan Note, this agreement to arbitrate all disputes, your agreement not to bring, join or participate in class actions, regarding collection of the loan, alleging fraud or misrepresentation, whether under the common law or pursuant to federal, state or local statute, regulation or ordinance, including disputes as to the matters subject to arbitration, or otherwise, shall be resolved by binding individual (and not joint) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed.
> This agreement to arbitrate all disputes shall apply no matter by whom or against whom the claim is filed. Rules and forms of the NAF may be obtained and all claims shall be filed at any NAF office, on the World Wide Web at www.arb-forum.com, or at the "National Arbitration Forum, P.O. Box 50191, Minneapolis, Minnesota 55405."

> Your arbitration fees may be waived by the NAF in the event you cannot afford to pay them. The cost of any participatory, documentary or telephone hearing, if one is held at your or our request, will be paid for solely by us as provided in the NAF Rules and, if a participatory hearing is requested, it will take place at a location near your residence. This arbitration agreement is made pursuant to a transaction involving interstate commerce. It shall be governed by the Federal Arbitration Act, 9 U.S.C. Sections 1-16. Judgment upon the award may be entered by any party in any court having jurisdiction.
>
> NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING ARBITRATION.

(All capitalization in original).

24. The language of the arbitration clause states that the National Arbitration Forum ("NAF") is the sole arbitration provider to be used:

> [A]ny claims . . . *shall* be resolved by binding individual (and not joint) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. . . . . Rules and forms of the NAF may be obtained and all claims *shall* be filed at any NAF office, on the World Wide Web at www.arb-forum.com, or at the 'National Arbitration Forum, PO Box 50191, Minneapolis, Minnesota 55405.'

(All emphasis added.) The use of the verb "shall" signifies necessity and command. The obligation to use the NAF is clear and mandatory. In addition, the clause appears to call for an exercise of NAF discretion in one area:

> Your arbitration fees *may be waived by the NAF* in the event you cannot afford to pay them.

(Emphasis added.)

25. The clause says arbitration shall be under NAF rules "in effect at the

time the claim is filed." The instant case was filed February 8, 2005. The NAF rules in effect then were as set out in the "Code of Procedure" dated January 1, 2005. Rule 1.A of the Code dated January 1, 2005 provides in part: "This Code shall be administered *only by* the National Arbitration Forum." (Emphasis added). The NAF rules in effect at subsequent dates have the same language.

26. The NAF Code governs all aspects of a claim, including the manner in which a claim can be brought, the selection of an arbitrator, the type of hearing afforded to the parties, the entry of an award, and the payment of fees (and waiver of those fees at the sole discretion of the NAF if a party contends she is unable to afford them).

27. The language designating the NAF as arbitration provider was not subject to negotiation. As stated in one of the agreements with County Bank signed by defendant Don Early:

> If you elect to join our program, you may not modify our loan application and note forms. . . . . *[A]ny variance, however slight,* could expose the Company, you, us and our other servicers to regulatory criticism and/or litigation liability.

28. The designation of the NAF as the sole arbitration organization was a mandatory, non-negotiable, integral and essential term of the arbitration clause.

F. THE NATIONAL ARBITRATION FORUM.

29. On July 14, 2009, the Minnesota Attorney General filed suit against the NAF and its successors. The Attorney General's suit alleged misconduct and favoritism in the NAF's administration of arbitration, and further alleged that the NAF was subject to a conflict of interest arising from a $42 million secret sale of a 40% ownership stake in an NAF subsidiary to participants in the consumer debt collection industry. Three days later, on July 17, 2009, the NAF entered into a Consent Judgment agreeing it would not administer or participate in any new consumer arbitration cases. Under the Consent Judgment, neither the NAF nor its affiliates can administer arbitration of the instant case or of any other case involving a consumer.

30. On April 6, 2011, the NAF executed a settlement agreement in which it formally stipulated that effective June 27, 2007 it became a holding company, transferred its operations to two subsidiaries and sold a 40% ownership interest in

one of the subsidiaries to participants in the consumer debt collection industry for $42 million.

31. Ms. Deanna Richert, a management employee of the NAF who was employed by the NAF and its affiliates from January 12, 2003 through September, 2008, was subpoenaed by plaintiffs and testified by deposition concerning NAF's arbitration practices.

32. In April 2009, Ms. Richert filed a lawsuit in the United States District Court, District of Minnesota, claiming she was denied promotions and terminated by the NAF because of discrimination based on her gender and age. In connection with this lawsuit, Ms. Richert prepared and filed an affidavit concerning the NAF's arbitration practices.

33. Ms. Richert testified that, in its arbitrations, NAF favored regular business claimants who were referred to at NAF as "famous parties." The "famous parties" were banks and collection agencies for the banks.

34. Ms. Richert witnessed NAF personnel give instructions to make sure that arbitrators who made arbitration rulings against "famous party" business claimants were not to be assigned to arbitrate any more cases, and that notations to this effect were placed in the computer containing the list of arbitrators. She witnessed NAF personnel being instructed to call arbitrators in cases where the arbitrator had made a decision against a "famous party" but had not yet sent the decision to the parties, to ask that the arbitrator change the decision. Ms. Richert also testified that in cases involving less than $75,000, the NAF gave the parties no choice of arbitrators and simply appointed a single arbitrator to decide the case.

35. Ms. Richert also described the NAF's accommodations and support for "famous party" business claimants as compared to consumer respondents: the NAF staff drafted claims and affidavits of service for the business claimants, including affixing electronic signatures so that the business claimants appeared to have "signed" these documents; NAF staff notified business claimants if their pleadings were technically deficient, whereas consumer pleadings were often dismissed and their defenses rejected as procedurally improper for minor technicalities such as failing to show a "cc" to business claimants; and NAF sales and marketing employees whose job it was to get businesses to include arbitration clauses in their contracts routinely requested that special procedures be used for and raised issues on behalf of the business claimants.

36. The NAF's ownership sale as admitted by the NAF and the NAF's

practices as described in Ms. Richert's testimony are not consistent with the neutrality, independence and disinterestedness that are essential features of legitimate arbitration processes. Through its assignment of arbitrators and otherwise, the NAF conducted itself as a service provider to the consumer debt collection industry, rather than as a truly independent and neutral administrator of arbitration services.

G. PROCEDURAL UNCONSCIONABILITY.

37. There was a great disparity of bargaining power between the payday-lender defendants and the payday-borrower plaintiffs. As of May of 2004, defendants QC Holdings, QC Financial Services and its wholly owned subsidiaries operated 295 stores in 21 states, including 20 stores in North Carolina. In contrast, the named plaintiffs were unsophisticated, with limited educations, and in a state of financial desperation, as shown by their repeated renewals and extensions of their payday loans and as shown by their testimony.

38. All terms of the loan agreements, including the arbitration agreement, were non-negotiable. Under the defendants' agreement with County Bank, no word or phrase in County Bank's loan documents could be changed.

39. The circumstances of the execution of the loan agreements were not conducive to disclosure or consideration of arbitration processes or the issues presented by the designation of the NAF. Loan transactions took place in a public location, at a counter, with a waiting line. Following their initial transactions, plaintiffs were compelled to accept the standard terms in order to renew their loans for a further time or suffer the consequences of having their post-dated checks presented to the bank for payment. Ms. Burke testified that when she ran late on a payment the store called her and said: "That I was going to go to jail if I didn't pay the loans; that I was writing bad checks; that they went in my account and tried to get their money out several times and it wasn't in there; and if I didn't pay these loans, that they were going to -- that I was going to be arrested."

40. Defendants did not disclose how the NAF operated, that the NAF was not a neutral forum, that the fees charged in the payday loans exceeded the limits permitted by the Consumer Finance Act, that Nationwide Budget Finance sought to use federal preemption to avoid the CFA, the true nature of the Financial Services of North Carolina relationship with County Bank, or the Financial Services of North Carolina confidential agreement with County Bank to be responsible for all legal problems and liabilities related to payday loans.

41. This Court previously found, in the *Kucan, Hager* and *McQuillan* cases

that every payday lender doing business in North Carolina required borrowers to execute loan agreements with mandatory pre-dispute binding arbitration clauses banning class actions. Defendants presented no evidence to alter this Court's prior finding. The Court finds the plaintiffs lacked any meaningful choice to obtain short-term consumer credit without agreeing to an arbitration clause prohibiting participation in a class action, as every payday lender with an office in North Carolina then required prospective borrowers to sign arbitration clauses prohibiting participation in class actions.

H. SUBSTANTIVE UNCONSCIONABILITY.

42. No individual arbitration cases have ever been brought challenging payday lending in North Carolina, either against the defendants in this case or against any other payday lenders. In light of the large number of North Carolina payday loan transactions that were undertaken by these defendants and the defendants in the other class cases after the statutory authority for payday lending in North Carolina expired on August 31, 2001, and in light of the evidence that all payday lenders required customers to sign loan agreements with arbitration clauses prohibiting participation in class actions, the complete absence of any individual arbitration cases tends to confirm that legal challenges to North Carolina payday lending conducted in cooperation with out-of-state banks could not be challenged in individual arbitration cases.

43. The language calling for arbitration before the NAF required plaintiffs to submit claims to an arbitration organization that sought to build business by encouraging relationships and providing accommodations to debt-collector arbitration claimants, and that on June 27, 2007, sold a 40% ownership interest to participants in the consumer debt collection industry. The NAF's lack of neutrality affected arbitrator selection. The arbitration clause requiring arbitration before the NAF was substantively unconscionable.

44. Plaintiffs offered the affidavit and deposition testimony of attorneys George Hausen, Glenn Barfield and Kenneth Schorr, with live testimony of Mr. Barfield and Mr. Hausen, each offering their opinion it was unlikely an individual payday borrower, proceeding on an individual (non-class) basis, would be able to obtain legal counsel to prosecute claims against defendants such as those raised in this proceeding.

45. The Court notes that each of these witnesses has been involved in recruiting North Carolina lawyers to take civil cases on behalf of low and moderate income persons in North Carolina, specifically including efforts to recruit lawyers both on a pro bono basis and on a fee basis. Mr. Hausen is and since 2002 has

been the Executive Director of Legal Aid of North Carolina. Mr. Schorr is the Executive Director of Legal Services of the Southern Piedmont, a nonprofit indigent civil legal services program, serving Charlotte and the western part of North Carolina. Mr. Barfield is a lawyer in private practice who is past president of Legal Services of North Carolina, Inc., and past chairman of the board of directors of Legal Aid of North Carolina. Both Mr. Hausen and Mr. Schorr are and have since 2005 been members of the North Carolina Equal Access to Justice Commission. Accordingly, the Court finds that these witnesses are particularly knowledgeable as to what cases North Carolina lawyers will accept, both on a fee basis and on a pro bono basis.

46. The Court accepts the testimony of Messrs. Barfield, Hausen and Schorr as experts. In addition, because the Court has had the opportunity to observe the demeanor of Mr. Hausen and Mr. Barfield, witnesses, the Court attaches particular weight to their testimony.

47. Mr. Barfield opined that, given the complexity involved in cases challenging payday lending in North Carolina presenting questions such as are in issue in this case, coupled with the motivation of the defendants to vigorously defend, the necessity for out-of-pocket expenditures, the uncertainty of prevailing and the lack of ability to use precedent in an arbitration forum, it is very unlikely that any North Carolina lawyer would be willing to bring such an individual case in arbitration. Mr. Barfield regularly represented defendants/counterclaimants in cases brought by "debt buyers" in counties close to his office. He wrote a manuscript to encourage attorneys across the state to engage in this work, but had virtually no success. In Mr. Barfield's opinion, the complexity of payday lending cases such as this case far exceeds the complexity of the cases he handled on behalf of consumers in the debt buyer cases. Mr. Barfield testified that it is simply not economically feasible to prosecute payday lending cases such as this case, in court or in arbitration on an individual basis.

48. Mr. Hausen opined that it is very unlikely that a payday borrower would be able to get representation from a Legal Aid or pro bono attorney in North Carolina. The demand for services far exceeds the capacity to provide legal representation. Legal Aid offices across the state prioritize cases involving basic needs such as preservation of shelter, access to health care, access to public benefits such as food stamps and Medicaid, and protection from domestic violence. Neither Legal Aid nor, in Mr. Hausen's opinion, the private attorneys whom legal Aid recruits to act as pro bono volunteer attorneys, would have the resources to act as attorneys for individual payday borrowers. While his office has devoted significant resources to foreclosure defense, including developing and implementing a series of training events for the private bar as a way to

encouraging referrals, it is not likely that such an effort would be replicated in an effort to represent payday lending borrowers. Neither Legal Aid nor the volunteer attorneys recruited to assist Legal Aid have enough resources to accept cases seeking the return of money from payday lenders.

49. Mr. Schorr testified that in his opinion, people who were payday lending borrowers would not be able to find attorneys at private firms or with nonprofit organizations to handle their claims on an individual basis. He testified that the amount of damages and attorneys' fees involved was not nearly at the threshold that would make it likely that a private attorney would take such a vase, and that nonprofit agencies would not handle them.

50. Messrs. Barfield, Hausen and Schorr each opined that because the stakes of an individual arbitration on behalf of a payday borrower are so small, no attorney would be willing to pursue a claim on behalf of a payday borrower on an individual basis. They go further to state that this is true despite the availability of statutory attorney fees under G.S. § 75-1.1 *et seq*. The individual claims for individual borrowers that are at issue in this case are in fact modest in amount. Plaintiffs represent that Mr. Torrence's largest damages claim is for treble the amount of his net interest, which, after trebling, is a total of $2,788.50. Ms. Burke's largest claim is for recovery of all amounts paid, but without trebling, which is a total of $561.

51. These witnesses also opined that because of the nature of the claim and the federal preemption issue, the claims in the instant case are complex. The instant case is complex because defendants contend they were engaged in marketing and servicing loans for County Bank. The Consumer Finance Act provides an exemption for banks. Under federal preemption laws, banks are not subject to state interest rate limits. To prove that defendants are subject to the CFA, a consumer must respond to defendants' claims concerning exemption and preemption. The complexity and proof will be substantially the same regardless of whether a claim is asserted on behalf of a single individual or on behalf of a class.

52. The CFA assigns regulatory responsibility over the small loan business to the North Carolina Commissioner of Banks. The Commissioner of Banks conducted an administrative case against Advance America, to determine whether that company was in violation of the CFA by conducting payday lending in North Carolina in cooperation with an out-of-state bank. An order in that case was rendered on December 22, 2005 (the "COB Opinion"), ruling that Advance America was in violation of the CFA.

53. The COB Opinion reflects that the issue of whether payday lenders can avoid application of the CFA by entering into contracts with banks is complicated. The COB Opinion is 54 single spaced pages and has 292 footnotes. Following an appeal, the COB Opinion was affirmed by order rendered by Judge Donald W. Stephens of Wake County Superior Court on March 29, 2010, who found that the required analysis is "heavily fact dependent," and that Advance America's claim to preemption was "not supported by the facts in this matter."

54. A legal challenge to the issue of whether defendants are lawfully permitted to participate in payday lending in North Carolina by purporting to act on behalf of an out-of-state bank would present a fundamental issue concerning whether defendants and other payday lenders with similar bank arrangements could continue to operate in North Carolina. A legal challenge over such a fundamental issue should be expected to give rise to a vigorous defense supported by resources that are more substantial that the amount in controversy in a single individual arbitration.

55. The successful prosecution of an individual claim that defendants in this case violated the CFA will likely require factual development through depositions, document review and expert analysis, just as the COB Opinion reflected factual development through depositions, document review and expert analysis.

56. The COB Opinion devoted substantial attention to financial relationships between Advance America and the various banks, to the actual results of such financial relationships, to the historical development of the relationships, to the companies' apparent business objectives, and similar matters.

57. Plaintiffs have submitted the affidavits and depositions of two financial experts. One of these experts, Ronald E. Copley, holds a Ph.D. in Finance, has been a tenured professor of Finance at the University of North Carolina at Wilmington, is a Chartered Financial Analyst, and is a licensed investment advisor. Dr. Copley reviewed the COB Opinion and has opined that it would require a minimum of 100 hours to perform financial analysis similar to the analysis performed by the Commissioner of Banks. The other of these experts, Michael J. Minikus, is a North Carolina certified public accountant. Mr. Minikus has opined that it would require a minimum of 65 hours to perform an analysis similar to the analysis performed by the Commissioner. Dr. Copley charges $225 per hour for his services. Mr. Minikus charges $125 per hour for his services. Regardless of how many hours must be devoted to analysis by a finance professional or a certified public

accountant, the costs of such experts are likely to exceed the amount in controversy in an individual case.

58. Regardless of whether the instant case will require as much analysis as set out in the COB Opinion, the legal issues in this case are too factually and legally complex to be addressed in an arbitration case involving only the amount of damages that would be at issue for a single plaintiff, because the time and expense required to be invested in such a case would be substantially in excess of the amount that could be recovered if the case was successful.

59. Defendants tendered the testimony of two North Carolina lawyers, Samuel Forehand and Woodward Webb, who stated that, in their opinion, some North Carolina lawyer would probably be willing to bring individual payday loan arbitration cases.

60. Attorneys Forehand and Webb acknowledged that they did not consider the complexities of a CFA case challenging payday lending in North Carolina done in cooperation with a bank, such as the preemption issue and the other issues identified in the COB Opinion. Mr. Webb provided representative examples of cases brought by consumer attorneys in North Carolina and other states in an effort to support his opinion that attorneys would accept representation on behalf of a payday borrower. None of these cases, however, involved usury claims, federal preemption, claims against a bank or a need for expert witness testimony. Until the preemption issues were brought to his attention at his deposition, Mr. Forehand was not aware that such a defense was likely to be involved in this case. Mr. Forehand acknowledged that he had no basis for disputing this Court's earlier finding in prior cases that litigating the preemption issue will require extensive deposition, document review and expert analysis as is reflected by the order of the Commissioner of Banks, or that the cost of expert witnesses alone would likely exceed the amounts at issue in individual cases.

61. The significance of the opinion testimony by attorneys Forehand and Webb is also diminished by their failure to identify any North Carolina lawyers who would in fact take such cases. Mr. Webb acknowledged that he would not accept one of these cases himself. In his deposition Mr. Webb mentioned three attorneys whom he thought might. However one of the attorneys mentioned was no longer in practice, and the other two attorneys signed affidavits stating that they would not take such cases on an individual basis. In his hearing testimony Webb mentioned a fourth attorney, but merely said he had spoken with the attorney in passing who said he would "look at it."

62. Defendants have objected to the tender of affidavits of expert witnesses who were not identified in interrogatory responses. The Court understands this to be an objection to Plaintiffs' Exhibits 47-49 (affidavits of Carlene McNulty, John Van Alst and M. Jason Williams). These affidavits are directed simply to the issue of three specific lawyers' willingness to take on individual cases challenging bank-contract payday lending. The objections are overruled.

63. Mr. Forehand testified that he would need to undertake a detailed case acceptance analysis before deciding whether he would take one of these cases, which he has not yet been able to complete; that even if he went through the process outlined in his affidavit, he would not be competent to state whether he would file an individual arbitration claim, having no prior experience with arbitration; and that he could not identify any attorney willing to represent a payday borrower or even meet with a payday borrower.

64. Defendants introduced two letters written by attorneys in North Carolina as evidence to show that payday lending borrowers were able to find legal representation. One letter made allegations that the payday loan was illegal and demanded that the payday loan company cease collection efforts. The other letter alleged that a payday borrower's check had been cashed prematurely. The defendants presented no evidence indicating that any relief was provided to the clients as a result of either letter, and no evidence that either of these attorneys undertook further representation on behalf of these borrowers or any other borrowers such as filing suit in court.

65. Even if North Carolina attorneys were willing to pursue an individual arbitration on behalf of an individual payday borrower, it is unlikely that payday borrowers generally would be able to obtain legal representation for individual claims, given all witnesses' inability to identify any lawyer who would accept such individual cases.

66. It is extremely unlikely that payday borrowers could effectively represent themselves in pro se litigation or arbitration against defendants in light of the complexity of the issues, including the factual and legal basis for federal preemption and statutory exemption.

67. Unless consumers received legal assistance that involved analyzing the legal legitimacy of payday lenders' claims to federal preemption and exemption, consumers would be unaware that they possessed any sound basis for a legal claim.

68. Defendants' witness Stephen Ware opined that NAF arbitration afforded consumers a reasonably accessible forum. Mr. Ware has never practiced law in North Carolina and has no familiarity with North Carolina law or North Carolina lawyers, and did not identify any North Carolina lawyer who is willing to take individual payday loan cases such as the instant case. Mr. Ware also did not review any pleadings in this case other than the complaint, did not review any of the briefs, affidavits or depositions in the case; and did not know what plaintiffs would have to prove in order to prevail. He had no opinion as to how many witnesses would be required to make out a claim, or whether expert testimony would be required; and had no knowledge of whether proof of intent would be required.

69. Mr. Ware based his opinion that NAF arbitration afforded consumers a reasonably accessible forum, by comparing the NAF to our court system as he contends it actually exists. Mr. Ware testified that, even taking the allegations of bias and corruption asserted by former managerial employee Deanna Richert as true, the NAF compares favorably to our court system, "given the pressure on a judge to rule in a particular way from a governor or legislator or a contributor to a judge's campaign."

70. Mr. Ware further based his opinion that NAF arbitration afforded consumers a reasonably accessible forum on information that thirteen individual arbitration claims had been advanced by Texas attorney Brian Blakeley in arbitration cases before the American Arbitration Association in which Mr. Blakeley contended that "QC Financial Services of Texas, Inc. was the 'true' lender for these payday loan transactions and that the fees collected by respondent constitute a deceptive practice and that the respondent has violated the Texas Credit Services Organization Act and/or engaged in usury."

71. Mr. Blakeley provided an affidavit which was introduced in evidence in the present case, and Mr. Blakeley was deposed by defendants. According to his affidavit, Mr. Blakeley began pursuing cases against Texas "credit service organizations" ("CSO's") in late 2009, and sought to assert usury claims on the ground that fees paid by his clients that were purportedly credit service organizations fees "should be considered to be interest because the CSO should be regarded as the true lender in the transaction; or because the relationship between the CSO and the purported lender is such that the purported lender and the CSO are not truly independent." Mr. Blakeley attached to his affidavit a Texas Attorney General letter opining that "[d]etermining the true relationship between a CSO and a lender would be a fact intensive endeavor."

72. However Mr. Blakeley stated in his affidavit and testified at his deposition that he had abandoned usury claims against Texas CSO's and was no longer asserting usury claims in connection with payday lending in Texas. Mr. Blakeley opined that "it is not possible to pursue usury claims on an individual basis in individual arbitrations conducted by the [AAA] for the following reasons," and gave five reasons that he believed such claims could not be pursued in AAA consumer proceedings.

73. Mr. Blakeley was deposed by defendants and provided testimony consistent with his affidavit. He continues to accept payday lending clients, and has been successful in seven out of twenty-two arbitration claims so far in cases involving Texas law disclosure claims unlike the claims in the present case. However, Mr. Blakeley has unequivocally abandoned all claims for usury and has no intention of bringing those claims in the future. Whether or not his decision to abandon these claims is because Mr. Blakeley is "lazy" as characterized by defendants or because the claims are not economically viable, the fact remains that Mr. Blakeley is not providing legal representation to Texas payday borrowers with fact-intensive claims concerning payday lenders' business relationships with third parties, and is not providing (nor has ever provided) any representation to North Carolina payday borrowers.

74. Mr. Blakeley practices law exclusively in Texas, and is not licensed to practice law in North Carolina. The claims brought by Mr. Blakeley in the payday arbitration cases were brought under Texas law, not North Carolina law.

75. The Court finds that payday borrowers would not be able to effectively vindicate the type of claims raised by plaintiffs here, even if the claims are legally justified and correct, if payday borrowers are required to proceed on an individual rather than class basis. The facts demonstrate that this conclusion is true, regardless of whether consumers were to attempt to pursue their claims in court or in arbitration.

76. The North Carolina Attorney General filed an amicus brief in *Kucan v. Advance America*, a North Carolina payday lending case alleging similar legal issues as are alleged in the instant case, stating that "no Attorney General will ever have the funds or personnel to pursue every remedy against every person or company preying on North Carolina customers" and that "it is critically important that consumers be able to rely on the private bar-- as the legislature intended-- for assistance in obtaining restitution for injuries caused by unfair or deceptive business practices."

77. Defendants' practice of holding customer checks as security for loans gave defendants considerable leverage in the event of a nonpayment or dispute, making resort to court or arbitration unnecessary: if the customer failed to pay defendants could simply deposit the check, either resulting in payment to defendants or causing the customer to be faced with the legal and practical consequences of having their check bounce.

78. The arbitration agreements restrict customers from bringing a class action. The agreement contains no corresponding prohibition against County Bank or any of the defendants bringing or participating in a class action.

CONCLUSIONS OF LAW

BASED ON THE FOREGOING FINDINGS OF FACT, and based on the evidence presented to the Court and the reasonable inferences to be drawn from that evidence, the Court makes the following conclusions of law:

A. CHOICE OF LAW.

1. As this case arises out of North Carolina consumers' transactions at offices located within North Carolina, the law of North Carolina governs this dispute. To the extent the payday loan documents provide that another state's law shall govern, those choice of law provisions are invalid.

B. NON-AVAILABILITY OF NATIONAL ARBITRATION FORUM.

2. The designation of the National Arbitration Forum ("NAF") as the sole arbitration provider and the designation of NAF rules were integral features of the arbitration clause. This is shown by the language of the arbitration clause, the circumstances of its execution, and by County Bank's insistence that the agreement could not be modified by even a single word or phrase. A party to a contract cannot require a term as essential, then contend the term was not significant.

3. Where, as here, it is determined as a matter of contract interpretation that the designation of a particular arbitration provider is "integral" rather than an "ancillary logistical concern," section 5 of the Federal Arbitration Act does not allow a court to appoint a substitute arbitrator. Defendants' "Motion for Appointment of Arbitrator" dated June 28, 2011 is therefore denied.

4. This Court declines to rewrite or modify the arbitration clause so as to provide for some other arbitrator or organization. The North Carolina Supreme

Court refused to rewrite or modify an arbitration clause in *Tillman v. Commercial Credit*, even though the agreement at issue in *Tillman did* contain a severability provision. In the instant case the agreement does *not* contain a severability clause. Therefore, there is less support for modification of the agreement than in *Tillman*.

5. The agreement must be enforced as written, or not at all. It cannot be enforced as written. Therefore, it cannot be enforced at all.

6. The unwillingness of the NAF to serve as arbitrator in consumer cases as reflected in the July 27, 2009 Consent Judgment, is a basis for denying defendants' motion to compel arbitration. The Court arrives at this conclusion separately and independently from the other conclusions of law within this order cited for denial of defendant's motion to compel arbitration.

7. Defendants have argued that "defenses to arbitration are properly decided by an arbitrator rather than this Court." This argument is rejected because the arbitrator designated by the arbitration clause, the National Arbitration Forum, is not available. The argument is also rejected because the language of the arbitration clause does not "clearly and unmistakably" refer clause formation issues to arbitration, and because plaintiffs challenge the delegation provision specifically.

C. NO VALID ARBITRATION AGREEMENT.

8. Arbitration is favored as a matter of both federal and state public policy. However if the specified arbitration process does not afford a genuine opportunity to resolve a subject of legitimate legal controversy-- that is, if the arbitration process does not permit a litigant to effectively vindicate legal rights-- then the arbitration clause may be unenforceable as a matter of contract formation law.

9. Under the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*, arbitration agreements must be treated like all other contracts.

10. The arbitration agreement in this case calls for arbitrations to be conducted only by the NAF. The NAF engaged in conduct that is inappropriate for an arbitration organization, including the June 27, 2007 sale of a 40% interest in the organization for $42 million, the arbitrator assignment process, and the assistance provided to debt-collector claimants but not to consumer respondents. NAF misconduct was testified to in this case by a former NAF employee whose employment at NAF dates back to January of 2003. Ms. Richert's testimony is

uncontradicted, and it states first-hand knowledge that the NAF manipulated arbitrator appointments to achieve positive results for claimants in NAF consumer collection arbitrations.

11. No agreement for "arbitration" administered by such an organization can be valid, and there could be no meeting of the minds with respect to an agreement to arbitrate under the auspices of such an organization in the absence of knowledge as to the nature and practices of the NAF.

12. Irrespective of NAF's lack of neutrality, the burden of proving a violation of the North Carolina Consumer Finance Act, with the accompanying showings required to address the federal preemption issue, could not be satisfied in an individual NAF consumer arbitration proceeding. This was not disclosed, and payday loan borrowers had no means of knowing this at the time they signed the arbitration agreements.

13. The arbitration agreement at issue did not become a valid contract because there was no meeting of the minds and because there was no legally effective and knowing consent. The Court arrives at this conclusion separately and independently from the other conclusions of law within this order cited for denial of defendant's motion to compel arbitration.

D. UNCONSCIONABILITY.

14. Under *Tillman*, an arbitration clause will not be enforced if the clause is unconscionable. Unconscionability is assessed by considering "all facts and circumstances" of a particular case. Unconscionability is a determination to be made "in light of a variety of factors not unifiable into a formula." In order to sustain a claim of unconscionability, both procedural and substantive unconscionability must be shown. *Tillman* adopts a "balancing approach" to the unconscionability question, and requires both a certain quantum of procedural unconscionability, and a certain quantum of substantive unconscionability.

15. Defendants contend *Tillman* has been overruled or modified by the United States Supreme Court in *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011). The court finds and concludes as a matter of law that *Concepcion* did not overrule *Tillman*. *Tillman* uses its "effectively vindicate" standard for substantive unconscionability based on United States Supreme Court precedent, and *Concepcion* does not overrule or address the effectively vindicate standard. Courts should not assume precedent that a higher court does not address has been overruled. Further, the holding in *Concepcion* is limited to overturning the "*Discover Bank* rule," which was a rule of automatic invalidation, in a case in which

the plaintiff would be able to effectively vindicate his rights in arbitration. In contrast, the *Tillman* standard involves consideration of all facts and circumstances, and the instant case involves plaintiffs who would not be able to effectively vindicate their rights in NAF arbitration. *Concepcion* did not involve an NAF arbitration.

16. Even if *Concepcion* is given a broader interpretation, it should not bar this Court from applying *Tillman* in the instant case, in which the arbitration clause requires that arbitration proceedings be administered by the NAF.

17. In *Tillman*, the Supreme Court concluded that the "oppressive and one-sided substantive provisions of the arbitration clause there at issue and the inequality of bargaining power between the parties rendered the arbitration clause in the plaintiffs' loan agreement unconscionable." 362 N.C. at 103, 655 S.E.2d at 370. In the instant case there was a pronounced inequality of bargaining power, because Nationwide Budget Finance was a lender engaged in millions of dollars of lending annually in North Carolina, while borrowers such as the named plaintiffs were individuals with a sufficiently desperate need for immediate funds that they were willing to commit to repay with interest at annual percentage rates such as 308%-318% and 469%-505%.

18. In addition, the terms of the loan agreement, including the arbitration clause, were set out in form documents that were non-negotiable: neither defendants nor any of their employees were authorized to modify the standard terms.

19. The fact that all payday lenders doing business in North Carolina required borrowers to execute loan agreements containing arbitration clauses prohibiting participation in class actions is also relevant to procedural unconscionability because this means that any borrower seeking such a loan would have had no alternative than to execute such an agreement if he or she sought a payday loan at any store.

20. The absence of disclosures concerning the NAF, the NAF arbitration process, the purpose of the agreement with County Bank and the other findings herein also support a finding of procedural unscionability.

21. Considering all the evidence, the Court finds there is sufficient evidence of procedural unconscionability to satisfy the procedural requirement under *Tillman*. *Tillman* emphasizes the parties' "inequality of bargaining power," and such inequality is present in the instant case. *Tillman* also notes the non-

negotiability of the contract terms tends to establish procedural unconscionability, and the contract terms in the instant case were non-negotiable. Moreover, in the instant case, unlike *Tillman*, there is uncontradicted evidence that all lenders providing payday loans required that borrowers sign an arbitration clause containing a prohibition on participation in class actions.

22. In *Tillman* the Supreme Court held that the provisions at issue in that case were substantively unconscionable "because the provisions do not provide plaintiffs with a forum in which they can effectively vindicate their rights" and would deter many consumers from seeking to vindicate their rights.

23. In the instant case, defendants structured Nationwide Budget Finance's loan business in such a manner as to make a legal challenge to Nationwide Budget Finance loans a complicated case requiring analysis of the financial terms of the contract between Nationwide Budget Finance and a bank, and the history of the relationships between Nationwide Budget Finance and banks. The complexities of the instant case arise because of the manner in which defendants arranged their North Carolina business. These complexities will require expert analysis and significant expenditures of legal effort.

24. The December 25, 2005 COB Opinion illustrates the complexity involved in the instant case, but does not eliminate or diminish the complexity of the instant case for purposes of an unconscionability analysis.

25. The evidence establishes that, given the complexity of the instant case, the amounts at issue in individual claims such as the claims asserted by the named plaintiffs are not sufficient to attract counsel to pursue the named plaintiffs' individual claims, either on a pro bono basis or on a contingency fee basis. The individual claims are too small to be pursued on a pay-by-the-hour basis, as the fees charged by counsel would exceed the amounts at issue in individual cases.

26. The costs of expert witnesses would likewise exceed the amounts at issue in individual cases.

27. The exculpatory effects are wholly one-sided, falling entirely upon consumers without burdening effectively any of defendants' rights. The prohibition on class actions in the loan agreement applies only to borrowers. While the arbitration clause's ban on class actions effectively extinguishes claims that might be brought by borrowers, it has no impact on defendants' legal rights.

28. The Nationwide Budget Finance practice of holding the customer's check as security for a payday loan, and the remedy preserved by defendants for

collecting on those checks, renders the arbitration clause one-sided. Nationwide Budget Finance could simply present the check for payment and instill fear of criminal prosecution in customers if the check is not paid (as happened with Ms. Burke).

29. The Court concludes that the arbitration clauses, including its prohibition on class actions, under the facts and circumstances of the instant case, are substantively unconscionable.

30. Having considered both procedural and substantive unconscionability, the Court concludes that the arbitration clause at issue in the instant case, including the prohibition on class actions, is unconscionable and may not be enforced.

E. EXCULPATORY CLAUSE.

31. Payday lending is a heavily regulated industry. There is significant public interest in protecting necessitous borrowers.

32. Because it serves as an exculpatory clause in contract between parties of disproportionate power, and because it involves a heavily regulated industry, the arbitration clause, including the prohibition on class actions, is an unlawful exculpatory clause and is unenforceable.

NOW, THEREFORE, IN LIGHT OF THE FOREGOING FINDINGS AND CONCLUSIONS, it is hereby ORDERED, ADJUDGED and DECREED that defendants' motion to compel arbitration and stay proceedings is hereby DENIED.

This the 27th day of Jan, 2012.

D. Jack Hooks, Jr.
Superior Court Judge Presiding