

## DOJ Takes On Tribal Lending: Inside The Indictments

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In recent months, the attention of the tribal lending industry has focused on the Consumer Financial Protection Bureau's emerging role in regulating short-term loans from sovereign tribal nations, but a new and even more powerful player has recently emerged that could play a role in shaping future discussions: the U.S. Department of Justice.

The DOJ's entrance into this arena was led by none other than the famed "Sheriff of Wall Street," Manhattan U.S. Attorney Preet Bharara. On Feb. 10, 2016, Bharara announced charges against Scott Tucker and colleagues for allegedly operating an illegal \$2 billion payday lending enterprise. The indictment in that matter alleges that Tucker recruited Native American tribes to provide the appearance that his companies were tribally owned, and thus protected by sovereign immunity from state lawsuits and regulators. This indictment was followed on April 7, 2016, by an indictment in the Eastern District of Pennsylvania claiming that Charles Hallinan and colleagues allegedly used tribes in a similar manner to protect illegal lending operations.

This article examines the structure of loans in question, the relationships between lenders and tribes that have been alleged to be mere pretense, and the specific charges brought by the federal government.

### Loan Structure

Several states prohibit payday loans, or have usury limits, that in effect, prohibit payday loans in their jurisdiction; these are known as "prohibited payday loan states." There are also states that restrict payday lenders by placing licensing requirements on those lenders, and capping interest rates at particular levels, these are known as "restricted payday loan states. The Tucker payday loan companies and the Hallinan payday loan companies did business in prohibited payday loan states, and failed to obtain the required licensing to operate in the regulated payday loan states.

According to the indictments, both companies charged fees of around \$30 for every \$100 borrowed, leading to annual interest rates exceeding 780 percent in violation of the law in prohibited and restricted payday loan states. The Tucker companies allegedly automatically withdrew entire interest payments due on loans, leaving the principal balance, so that when the next paycheck came due, the lender could again automatically withdraw an amount equal to the entire interest payment due on the loan, which had already been paid. None of the money paid was applied towards the principal until



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about the fifth paycheck, and at that point, the Tucker companies withdrew an additional \$50 per payday to apply towards the principal of the loan. When customers complained to state regulators or threatened to sue, the Tucker companies stopped withdrawing additional money from the consumer's account and canceled the "remaining balance."

Similarly, Hallinan allegedly directed his businesses to roll over any loans that were not repaid on time and charge additional fees, resulting in borrowers repaying significantly more in fees than the entire amount of their loans.

In order to gain access to as many potential customers as possible, both the Tucker and the Hallinan companies used lead generators that employed TV ads or other types of marketing to get potential consumers to go to the lead generator's website. Visitors entered personal information such as name, employer, income, bank accounts, date of birth or Social Security number, and the lead generator would "connect" the borrowers to the website of a payday lender, which in their respective cases, was owned by the Tucker or the Hallinan companies. The loans were finalized over the Internet, the lender would wire the requested funds into a borrower's bank account, and then, later, withdrew any amounts due.

The DOJ claims that the structure of the loan repayment on the allegedly usurious loans caused customer's bank accounts to incur negative balances, creating a downward debt spiral, by necessitating that borrowers obtain additional payday loans to reimburse their banks for the negative balances, and to pay ordinary living expenses that could have been paid if the consumer didn't have to reimburse their bank.

### **Alleged "Sham" Relationships**

The indictment alleges that at all times, Tucker and Hallinan were the source of all funds lent to borrowers, they controlled the day-to-day operations, finances, distribution of profits, advertising, and, made all major decisions related to the payday loan businesses. Despite their complete ownership and control over the payday loan companies, Tucker and Hallinan allegedly attempted to evade state and federal law by covering their business in the cloak of tribal sovereign immunity. The indictments claim that both Tucker and Hallinan entered into what the DOJ has labeled "sham" business relationships with Indian tribes in order to defeat state court lawsuits, avoid future civil and criminal liability for their conduct, and to continue their loan businesses by asserting tribal sovereign immunity.

In the indictment against Tucker, the DOJ alleges that, to perpetuate the alleged "sham" relationship, Tucker assigned nominal ownership to the tribes, and listed them as owners on certain corporate and financial documents. Tucker also had his attorney prepare and submit false and misleading affidavits regarding the relationship between Tucker and the tribes, creating a false impression that the tribes played a substantial role in the ownership and operation of the payday companies. Because of these allegedly false affidavits, state courts dismissed certain state lawsuits on the grounds of tribal sovereign immunity, even though the tribes in fact had no power to make decisions, had no control over income or expenses, and, were not entitled to profits of the Tucker companies. Amazingly, the indictment further alleges that Tucker's attorney went so far as to file a fake lawsuit against one of his own "clients" to create the illusion of tribal ownership and control over the payday lender.

In Hallinan's case, it is alleged that his attorney drafted a series of contracts purporting to memorialize the agreement with the "hereditary chief" of a Canadian tribe, including a common stock purchase agreement, which gave the appearance of the Canadian tribe purchasing the company from Hallinan.

The indictments also paint a picture of how Tucker and Hallinan used computers kept on tribal lands to create a false impression of tribal involvement in the enterprises. Tucker allegedly had tribal members press a key on a computer on a daily basis, on tribal lands, to “approve” hundreds and thousands of loans that had already been approved by other Tucker companies. Tucker even had call center employees located in Kansas claim that they were located on reservation lands in Oklahoma or Nebraska and provided daily weather reports for those locations so that employees could complete the illusion. The indictment charging Hallinan alleges that Hallinan sent a computer server associated with the payday lending operation to a California-based tribe so that it could officially be “installed” on tribal lands. However, the tribe was prohibited from accessing any of the information on the server regarding the payday loan customers or company operations.

The Tucker indictment does not outline a particular payment structure to the Tribes in exchange for asserting their tribal sovereign immunity, but the Hallinan Indictment outlines specific payments to the tribes. Hallinan is alleged to have paid various tribes upwards of \$10,000-\$20,000 a month through wire transfers in return for the tribe’s agreement to claim ownership and sovereign tribal immunity whenever prohibited or regulated payday loan states, or their residents, attempted to enforce state laws against the Hallinan companies. Hallinan started with a tribe in Oklahoma, and paid the tribe to assert that it issued the payday loans. He later transferred the “operations” from the Oklahoma tribe to a Canadian-based tribe, and then to a federally recognized California-based tribe.

### **Notable Charges Found in the Indictments**

#### ***RICO: Conspiracy to Collect Unlawful Debts and The Collection of Unlawful Debts***

In the separate indictments, the DOJ alleges that Tucker, Hallinan, their companies and related associates constituted an “enterprise” as defined by the Racketeer Influenced and Corrupt Organizations Act statutes. The DOJ charges that both loan companies violated RICO by collecting unlawful debts, as defined by Title 18 U.S.C. §1961(6) which are debts that are unenforceable under “(A) State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the ... business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate.” The DOJ alleges that it was a part of both the Tucker and Hallinan conspiracies that the defendants agreed that a conspirator would commit at least one collection of unlawful debt in the conduct of the affairs of the enterprise.

#### ***Truth in Lending Act Violations — Tucker***

The Tucker indictment also charges violations of the Truth in Lending Act. The Tucker lending websites contained a “Disclosure of Credit Terms.” Under the Truth in Lending Act, a “Disclosure of Credit Terms,” is supposed to clearly state the cost of the loan to a borrower. 15 U.S.C. §1601 et seq. The indictment alleges that the Tucker credit terms disclosure falsely stated that for a \$500 loan, the finance charge would be \$150, when, in reality, the annualize interest rate was closer to 782 percent.

#### ***Mail and Wire Fraud — Hallinan***

The Hallinan indictment also contain mail and wire fraud charges that stem from a previous lawsuit in Indiana alleging that a Hallinan company had violated Indiana consumer protection statutes by issuing payday loans with usurious finance charges to Indiana residents. These charges stem from allegedly false representations to the IRS and state authorities on the ownership of the Hallinan company and emails, letters, monthly amounts transferred by wire, and the amounts transferred by international wire to a

tribal fund from Hallinan that the DOJ alleges were allegedly intended to create the false impression that the Canadian tribe purchased the company from Hallinan.

## **Conclusion**

The arrival of DOJ criminal indictments in any industry always creates significant “shock and awe.” The tribal lending arena is no different. But, while these indictments certainly are an important new development in this industry, they need not signal the end for the tribal lending industry. It should be clear, however, that the DOJ, in addition to the CFPB, intends to cast a particularly watchful eye on the true nature of the relationship between tribal lenders and their outside partners. The Tucker and Hallinan indictments establish that the DOJ will examine these relationships with an eye toward determining whether tribes engaged in lending operations have significant ownership in the enterprise, involvement in the day-to-day operations of the company, and maintain a robust compliance and regulatory infrastructure. In the end, these indictments may have a beneficial impact on relationships between tribal lenders and their outside partners by making it clear that the balance of power in these relationships must reside with the tribe.

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