

STATE OF NEW YORK
SUPREME COURT

COUNTY OF ALBANY

PEOPLE OF THE STATE OF NEW YORK,
by ELIOT SPITZER, Attorney General
of the State of New York,
Petitioner,

-against-

DECISION AND ORDER
INDEX NO. 5302-04

JAG NY, LLC., d/b/a N.Y. CATALOG
SALES, and JOHN A. GILL, JR.,
Individually and as a Principal
of JAG NR, LLC.,
Respondents.

(Supreme Court, Albany Co. Motion Term - December 6, 2004)
(RJI No. 0104-079381)

(Justice Bernard J. Malone, Jr., Presiding)

APPEARANCES: Hon. Eliot Spitzer
Attorney General of the State of New York
Attorney for Plaintiff
(Mark D. Fleischer, Esq., of Counsel)
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Albany, New York 12224

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MALONE, J:

This is a special proceeding brought by the Attorney General against the respondents JAG NY, LLC, d/b/a N.Y. Catalog Sales (JAG) and John A. Gill, Jr., an alleged principal of JAG, for a permanent injunction, restitution, damages, civil penalties and costs upon

the grounds that the respondents are operating an illegal payday checking service providing short term loans at usurious rates of interest and that they are engaging in improper collection practices.

JAG is a limited liability company that operates three stores in the State of New York, one in the Town of Queensbury and two in Watertown adjoining the Fort Drum Military Reservation. Respondents contend that their business is selling merchandise from catalogs and, as a feature of their business, a customer can write a check for an amount in excess of the purchase price of the merchandise or gift certificates and receive cash back. The Attorney General contends that the respondents' actual business is the making of short term payday loans at usurious interest rates and that the catalog sales are a sham to cover the illegal loans. The respondents place advertisements in newspapers and on the radio, publish fliers, place store window signs and use sandwich boards advertising the ability of consumers to obtain money at their stores, regardless of the consumer's credit history. The main thrust of these advertisements is the ability of customers to obtain immediate cash. The references to catalog sales are in much smaller print. In their memorandum of law, the respondents state that JAG does business in the following manner:

"A customer can qualify to do business with JAG NY by presenting evidence of current employment and an open checking account. At the three JAG NY showrooms, catalogs are available so that customers may browse

through them and select merchandise for purchase. Alternatively, a customer can purchase a catalog for \$3 and take the catalog home so that they may browse for merchandise at their convenience and in the comfort of their home¹. The customer may either order merchandise at the time they enter the store, or may instead purchase a gift certificate for use in ordering merchandise at a later date.² Purchases of gift certificates are in preprinted denominations of either \$15 or \$30. Upon purchasing merchandise or a gift certificate, a customer is entitled to write a check above the amount of merchandise or certificates purchased. The permissible limits are set forth in Exhibit "D" to the Waits Affidavit, but in general, a customer can write for \$100 in excess of every \$30 of merchandise or gift certificates purchased. There are other limits on the amount of any customer transaction. For instance, the customer's check may not exceed 50% of the customer's net pay.

The checks are deposited in time to be presented against the customer's checking account on his or her next payday. Customers are told that checks will be deposited on their next payday, but that they have option to come back to the store on or before the next payday and pay the amount of their check in cash. This is known as 'picking up' a check. If a customer picks up a check for cash, that customer can enter into another transaction. If the customer allows the check, to be deposited, he cannot enter into another transaction until his check fully clears collection. Many customers engage in repeat transactions, meaning that they will do business with JAG NY several times over the course of a year."

The advertisements inform consumers that they can obtain a cash advance of up to \$500.00 by purchasing a gift certificate or catalog merchandise and writing a check in an amount over the costs of the certificate or merchandise. JAG currently uses only one

catalog offering merchandise supplied by an independent wholesaler. In the past, the three stores had two catalogs available. Before a customer can write a check in excess of the price of the gift certificate, he or she must complete an application form which includes the consumer's social security number, bank account numbers and personal and professional references.

The petitioner contends that most of the people doing business with JAG are there to obtain short term loans to meet their financial needs until their next payday. Supporting this argument the petitioner asserts that the merchandise offered in the catalog is of dubious quality and can be purchased from other retailers at significantly lower prices. The petitioner further argues that JAG's customers do not redeem most of their certificates. Finally the petitioner states that the practice of requiring a customer to pay \$30.00 for what he claims is a worthless gift certificate in order to obtain a \$100.00 cash loan is the same as an interest rate of 720 percent per year.

Additionally, petitioner asserts that the respondents also engage in illegal collection practices when a customer has insufficient funds to honor his or her check when it makes daily telephone collection calls to the consumer both at home and at work and by also disclosing the consumer's failure to honor a check to customers' employers and colleagues.

The petitioner has filed this proceeding pursuant to Executive

Law section 63(12) which provides as follows:

"Whenever any person shall engage in repeated fraudulent or illegal acts or otherwise demonstrate persistent fraud or illegality in the carrying on, conducting or transaction of business, the attorney general may apply, in the name of the people of the state of New York, to the supreme court of the state of New York, on notice of five days, for an order enjoining the continuance of such business activity or of any fraudulent or illegal acts, directing restitution and damages and, in an appropriate case, cancelling any certificate filed under and by virtue of the provisions of section four hundred forty of the former penal law or section one hundred thirty of the general business law, and the court may award the relief applied for or so much thereof as it may deem proper. The word 'fraud' or 'fraudulent' as used herein shall include any device, scheme or artifice to defraud and any deception, misrepresentation, concealment, suppression, false pretense, false promise or unconscionable contractual provisions. The term 'persistent fraud' or 'illegality' as used herein shall include continuance or carrying on of any fraudulent or illegal act or conduct. The term 'repeated' as used herein shall include repetition of any separate and distinct fraudulent or illegal act, or conduct which affects more than one person."

The Court notes that the fraudulent and illegal activities addressed by the statute include "unconscionable contractual provisions" and conduct affecting more than one person. Clearly, the submissions made by the petitioner have established as a matter of law that the conduct under review affects more than one person. Also, if it is determined that the cash advances being made by the respondents are usurious they would be "unconscionable contractual provisions" under the language of the statute

The first cause of action in the petition alleges a violation of General Obligations Law section 5-501, New York's civil usury

statute, which makes it unlawful to charge interest upon a loan or forbearance of any goods, money or things in action at a rate exceeding that proscribed in Banking Law section 14-a, which rate is currently 16 percent.

The second cause of action alleges a violation of Penal Law section 190.40, New York's criminal usury statute which prohibits a loan at an interest rate exceeding 25 percent

The third cause of action alleges a violation of Banking Law section 340, a statute addressed to unlicensed lending, which prohibits any person or entity to "engage in the business of making loans in the principal amount of \$25,000.00 or less for any loan to an individual for personal, family, household, or investment purposes *** and charge, contract for, or receive a greater rate of interest than a lender would be permitted by law to charge if he were not a licensee hereunder except as authorized by this article and without first obtaining a license from the superintendent." It is alleged and not denied that the respondents were not licensed by the New York State Superintendent of Banking at the time of the transactions giving rise to this litigation.

The fourth cause of action alleges a violation of General Business Law article 29-H which prohibits, among other things, a creditor from communicating the nature of a consumer claim to a debtor's employer prior to obtaining final judgment against the debtor and from communicating with a debtor with such frequency as

can be reasonably expected to abuse or harass the debtor.

The fifth cause of action alleges a violation of Executive Law section 63(12) for repeated fraudulent business conduct.

The Court will first address the issue of whether the cash advances made by JAG are loans of money at usurious rates. The "purpose of usury laws from time immemorial, has been to protect desperately poor people from the consequences of their own desperation" (Schneider v Phelps, 41 NY2d 238, 243). "In order for a transaction to constitute a [usurious] loan, there must be a borrower and a lender; and it must appear that the real purpose of the transaction was, on the one side, to lend money at usurious interest reserved in some form by the contract and, on the other side, to borrow upon the usurious terms dictated by the lender" (Donatelli v Siskind, 170 AD2d 433, 434). "When a transaction is truly an illegal, usurious loan, there is obviously a motivation to disguise it to look like a legal non-usurious transaction; and thus the fact that the transaction is in form legal and non-usurious will not prevent courts from examining the transaction to see whether the true nature of the transaction is not what its form indicates" (Kuklis v Treister, 83 AD2d 545). "If it appears that the parties are making a loan, then the transaction will be considered a loan without regard to its form or to the fact that the parties call it by some other name" (The Tuition Plan, Inc. v Zicari, 70 Misc2d 918, 921).

In support of his application the petitioner has submitted: copies of the respondents' newspaper advertisements; transcripts of the deposition testimony of Mr. Gill, two current employees of JAG and a former employee of JAG; an affidavit from another former employee of JAG; an affidavit from a former intern with the Attorney General setting forth the results of her internet comparison of the prices for the merchandise in JAG's catalog compared to prices for the same merchandise available from other vendors on the internet; a copy of JAG's employee handbook; JAG's application form for customers to receive cash advances; a report of all consumer transactions at JAG's Queensbury store between May of 2000 through early November 2002; the affidavits of twenty consumers who have done business with JAG; and two affidavits from former employees of JAG

These submissions by the petitioner show to the Court that JAG primarily advertises its service as a method by which employed people can borrow money until their next pay. But, in order to do so those people must also purchase gift certificates or merchandise out of the catalog maintained at respondents' stores. It is quite clear from the voluminous papers submitted (see pp. 15-16 of this decision) that most of the people who use JAG's stores do so to borrow money. It is also clear that a substantial majority of JAG's customers do not redeem a substantial majority of their certificates.

has submitted affidavits of four of its thousands of customers who state they are satisfied with how JAG does business. "The existence of satisfied customers in no way excuses violations of the *** law" (State of New York v Midland Equities of New York, Inc., 117 Misc2d 203, 207 The respondents also submitted affidavits from Mr. Gill and three of GAG's employees alleging that JAG does not make loans, has many customers who use their gift certificates, and that the merchandise in Jag's catalog is sold at comparable prices by other merchants. The respondents also argue that the complaints set forth by the twenty consumers relied upon by the Attorney General constitute only a small proportion of their customers. In the case of State of New York v Princess Prestige Co., Inc., 42 NY 104, 107, the Court of Appeals stated:

"The record established that respondents by their conduct failed to comply with the statutory requirements as to home solicitation sales. This conclusion is not vitiated by the fact that the proceeding was initiated on the basis of 16 complaints out of what respondents tell us were some 3,600 transactions."

Accordingly, this Court finds that the contention that only twenty customers who have complained of illegal, usurious cash loans is not a basis for failing to find a violation of the usury statutes is legally insufficient to defeat the claim

respondents also argue that their submissions have raised triable issues of fact requiring a hearing and that the denial of that hearing would render Executive Law section 63(12) unconstitutional by depriving the respondents of property without

notice and the opportunity to be heard. A special proceeding such as this is designed for expedited relief and the "same test as applied to a motion for summary judgment is used to determine a special proceeding" (Jones v Marcy, 135 AD2d 887) Unsubstantiated, self-serving assertions will not serve to raise a question of fact requiring a hearing (Matter of People of the State of New York v Telehublink Corp., 301 AD2d 1006, 1008). A telemarketer's conclusory claim that it complied with all relevant laws was insufficient to rebut the petitioner's *prima facie* showing that New York consumers were being subjected to illegal transactions (supra, at 1009). In this Court's view submissions by the respondents fail to raise a triable issue of fact sufficient to require a hearing.

As to the proffered due process defense, the respondents know that they have been investigated by the petitioner Attorney General for years and were clearly apprised of the underlying allegations being made against them. They have had ample opportunity to forth their positions in their voluminous answering papers and also during oral argument. The Court finds that there has been no violation of the Due Process Clauses of either the Federal or State Constitutions (People of the State of New York v Apple Health and Sports Club, Ltd., Inc., 80 NY2d 803).

This Court finds upon the voluminous record before it that the respondents are, as a matter of law, engaged in a scheme to make

loans which are usurious. If "a pretended sale of goods is made the underlying scheme for loaning money upon usury, the courts will be vigilant to judge the transaction by its real character rather than the form and color which the parties have seen fit to give it" (Archer Motor Co. v Relin, 255 AD2d 333, 334). The practice of selling near worthless gift coupons as the basis for advancing cash at an illegal interest rate has long been condemned (Glover v Buchman, 104 SW2d 66). A scheme which seems to be identical to the one before this Court was addressed in the case of Cash Back Catalog Sales, Inc. v Price, 102 FS2d 1375, 1380, 1381, and that court stated:

"When presented with payday loans like these, the Arkansas Supreme Court reasoned:

While the agreed statement shows that the articles of merchandise can be ordered through the lender's agent at fair prices, there is no pretense they can be had at bargain prices ... But it is unreasonable to expect needy persons, as a rule, to make full use of such a coupon, exacted from their necessity when they borrow a hundred dollars. Glover v Buckman, 104 S.W.2d 66, 67 (Tex. Civ. App. 1937). A reasonable trier of fact could conclude that the amount of the gift certificates are, in substance, interest charges paid by Price.

I make no factual finding, but it seems obvious to me that 'check cashing' is the main event. The reduced advance is the hook. The gift certificate only makes it look better. It may be true that customers can buy a gift certificate even if they do not cash a check. Why or how often anyone would do such a thing would be an interesting inquiry. I cannot imagine a brisk business in gift certificates alone."

While the judge in the Cash Back Catalog Sales case declined to determine as a matter of law that the gift certificates were used to conceal a usurious loan, this Justice does not, after due

deliberation, reach the same result. The petitioner has submitted overwhelming evidence that almost all of JAG's customers use its services in order to obtain cash to be used by them until their next payday. In the ordinary course of business a merchant receiving checks would deposit those checks as soon as possible. If JAG is not operating as a check cashing service why is it agreeing to hold its customers' checks until the next payday? another way, vendors do not simply give their customers vendors' own cash to be held without repayment over a period of time without getting some return on their own money. Accordingly, upon this record, the Court determines that JAG has been and is engaged in making usurious payday loans.

The petitioner is awarded a permanent injunction prohibiting the respondents from cashing check for customers in amounts in excess of the face value of the merchandise or gift certificates that the customers purchase, except upon the condition that the check be deposited by JAG on the same or next business day, is, in the normal course of business

The issuance of a permanent injunction against the respondents is based upon a finding that the respondents violated the civil usury prohibition set forth in General Obligations Law section 5-501. This Court makes no determination, without prejudice to a separate inquiry or proceeding as to whether the respondents violated the criminal usury provisions of Penal Law section 190.40.

The determination that the respondents made usurious loans without appropriate license from the New York State Superintendent of Banking establishes a violation of Banking Law section Further, the usurious loans are "unconscionable contractual provisions" and therefore are fraud pursuant to Executive section 63(12).

With respect to the unlawful collection practices allegation, JAG's own Employee Manual directs its employees to make daily contact with debtors to persuade them to pay. JAG employees admit that they made telephone calls to supervisors and colleagues of debtor soldiers and, if those supervisors and colleagues inquired about the nature of the call, they would disclose information concerning the unpaid debts. That is a violation of General Business Law section 601 (b)

As to Mr. Gill's personal liability, New York law is settled that an officer or director of a corporation may be liable for the fraud of the corporation if he or she participated in it or had actual knowledge of it (People of the State of New York v Apple Health & Sports Club, Ltd., Inc., 80 NY2d 803, 807). Mr. Gill's testimony from his deposition before the Attorney General establishes his culpability for the acts of JAG prior to his resigning his position as managing member, which position this Court equates with that of officer and director for purposes of personal liability.

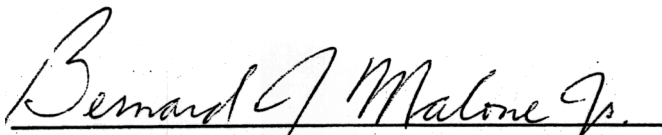
The petitioner requests that this Court declare null and void any loan made by JAG which charged a usurious interest rate. If a debtor has not made any repayment upon a usurious loan the debtor is released from the obligation to pay both the principal and interest (Russo v Carey, 271 AD2d 889). However, once a borrower starts to repay a usurious loan, the borrower can only recover from the lender the amount of money the borrower paid that is more than the legal interest (Dollar Dry Dock Savings Bank of N.Y. v Bellino, 206 AD2d 499, 500). The determination of each borrower's obligation to repay his or her loan to JAG is going to have to be made on a case by case basis in accordance with the precedents set forth above. The same will be true with respect to the amount of restitution, if any, to be awarded to each of JAG's customers. Upon application the Court will appoint one or more referee to hear and determine each customer's complaints against the respondents. The Attorney General, in the first instance, shall pay the referee's fee (Matter of People v Introductions Inc., 252 AD2d 631). Finally, petitioner is entitled to awards of \$2,000.00 statutory costs against each respondent.

All papers, including this decision and order, are being returned to the Office of the Attorney General. The signing of this decision and order shall not constitute entry, notice of entry or filing under CPLR 2220

This memorandum shall constitute both the decision and the order of the Court.

IT IS SO ORDERED.

DATED: ALBANY, NEW YORK
JANUARY 20, 2005


BERNARD J. MALONE, JR., J.S.C

PAPERS CONSIDERED:

notice of petition dated August 27, 2004;
petition verified August 27, 2004, with exhibits;
affidavit of Kylie Seery sworn to September 5, 2003;
affidavit of Laura Silverstein sworn to August 8, 2003;
answer verified October 14, 2004;
affidavit of Nancy Favry sworn to during October 2004;
affidavit of Dawn Musick sworn to during October 2004;
affidavit of John A. Gill, Jr., sworn to October 8, 2004, with exhibits;
affidavit of Deborah Waits sworn to October 12, 2004, with exhibits;
affidavit of Winifred A. Sharrow sworn to October 12, 2004, with exhibit;
affidavit of Amy J. Putnam sworn to October 12, 2004, with exhibits;
affidavit of Andrew C. Maulbetsch sworn to October 13, 2004, with exhibits;
affidavit of Michael Lockaby sworn to October 14, 2004;
affidavit of Cora Lockaby sworn to October 14, 2004;
reply affirmation of Mark D. Fleischer dated November 8, 2004, with exhibits;
affidavit of Nancy Fitzgerald sworn to September 28, 2004;
affidavit of Pamela Wells sworn to September 14, 2004;
affidavit of James Bills sworn to September 27, 2004;
affidavit of Veronica Bounds sworn to September 22, 2004;
affidavit of Vicki Canale sworn to October 15, 2004;
affidavit of Sharon A. Conway sworn to September 10, 2004;
affidavit of Maria Dawkins sworn to October 19, 2004;
affidavit of John Gallagher sworn to September 16, 2004;
affidavit of Danielle Harper sworn to October 18, 2004;
affidavit of Amelia Hill sworn to September 28, 2004;
affidavit of Sarah Hillis sworn to October 4, 2004;
affidavit of Sheri Hughes sworn to September 30, 2004;

affidavit of Thomas Manley sworn to September 28, 2004;
affidavit of Jessica McWain sworn to October 8, 2004;
affidavit of Robert Olcott sworn to October 4, 2004;
affidavit of Sandra Parrow sworn to October 25, 2004;
affidavit of Mark Phillips sworn to September 28, 2004;
affidavit of Jennifer Schermerhorn sworn to September 23, 2004;
affidavit of Zenova St. Louis-Dudley sworn to October 22, 2004;
affidavit of Leslie Stackel sworn to October 22, 2004;
affidavit of Thomas Stackel sworn to October 1, 2004;
affidavit of Michael Sullivan sworn to October 14, 2004;
affirmation of Roland M. Cavalier dated November 18, 2004;
reply affirmation of Roland M. Cavalier dated December 3, 2004;
sur-reply affirmation of Mark D. Fleischer dated November 30, 2004;
reply affidavit of Deborah Waits sworn to November 22, 2004, with
exhibit;
affirmation of Roland M. Cavalier dated November 18, 2004;
reply affidavit of Deborah Waits sworn to November 22, 2004, with
exhibits.
