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Payday Loans:
Shrewd Business or Predatory Lending?

Creola Johnson†

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INTRODUCTION

Payday loans are extremely high-interest, short-term loans offered to cash-strapped consumers. Some of the problems with payday loans can be illustrated succinctly by the experience of one payday loan customer, Leticia Ortega. Realizing that her next payday was two weeks away, Ortega worried about how she was going to get enough cash to pay overdue telephone and electric bills. Then Ortega, a cashier in San Antonio, Texas, spotted an advertisement by National Money Service in a local weekly newspaper. National Money Service charged her a $90 interest fee for a $300 loan, due by her next payday. Calculated on an annual percentage rate (APR) basis, this fee amounts to an APR of 780%. When the loan's due date arrived, Ortega did not have sufficient cash to repay the entire loan. Consequently, for almost a year, National Money Service

1. Ortega is a typical payday loan customer. For further explanation as to why she is considered a typical payday loan customer, see discussion infra Part I.B.
3. Id.
4. Id.
5. The court in Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375, 1379 n.3 (S.D. Ga. 2000) set forth the formula for calculating an APR. Based on a fifty-two week year with "R" representing the APR, "T" the finance charge, "T" the term (weeks) of the loan, and "P" the loan principle: \( R \times \frac{P}{52} \) \( T = I \). Applying this formula to Ortega's loan yields the following calculation and result: 1. \((R \times $300 / 52) \times 2 = $90\). 2. \((300R / 52) \times 2 = $90\). 3. \(5.77R \times 2 = $90\). 4. \(11.54R = $90\). 5. \(R = $90 / 11.54\). 6. \(R = 7.80\). Accordingly, Ortega's loan carried an APR of 780%.
debited Ortega's bank account every two weeks in the amount of $90 as interest to "roll over" the loan (i.e., extend the due date).\textsuperscript{7} Because none of the $90 interest payments counted as principal, Ortega still owed National Money Service $300 even though she had paid $1800 in interest charges.\textsuperscript{8} Subsequently, Ortega filed a complaint against National Money Service with the state and learned that Texas usury law restricts lending charges.\textsuperscript{9} Because it had partnered with a bank located in Delaware, however, National Money Service claimed it was not subject to Texas usury law but could instead issue payday loans charging the maximum interest rate allowed under Delaware law, the bank's home state.\textsuperscript{10} This lawsuit is still pending.

Ortega's experience with National Money Service brings to light three of the major criticisms lodged against the payday loan industry.\textsuperscript{11} First, because payday lenders charge fees constituting extremely high-interest rates, these lenders are modern-day loan sharks.\textsuperscript{12} Second, because the payday loan business model requires payment of the loan in full and does not allow partial payments or renewal fees to reduce the

\textsuperscript{7} Id.
\textsuperscript{8} Id.
\textsuperscript{9} Id. Under Texas's consumer loan law, a lender can charge up to $15.60 for a fourteen-day loan of $300. See 7 TEX. ADMIN. CODE § 1.605(c) (West 2002) (containing an exhibit that "provides examples of the maximum authorized rates for loans made under Texas Finance Code"). The lender cannot renew or roll over a loan if doing so results in charges exceeding that maximum permitted fee. See id. § 1.605(f)(1).
\textsuperscript{10} Geller, supra note 2. The Delaware bank is the County Bank of Rehoboth Beach. Id.
\textsuperscript{11} The Community Financial Services Association of America, a payday lending industry trade group, operates a website that responds to these criticisms at http://www.cfsa.net/pressreleases/bestpractices-pr.html.
principal, payday lenders trap consumers in a vicious cycle of indebtedness.\(^\text{13}\) Third, payday lenders are partnering with national banks in order to take advantage of a loophole in federal banking law that allows them to charge rates in excess of state law.\(^\text{14}\)

Disguising payday loans, threatening criminal prosecution, and collecting excessive damages are among the other major complaints lodged against the industry. To evade compliance with state usury limits and federal and state disclosure requirements, payday lenders in some localities disguise the payday loan transaction with a layer of subterfuge such as selling advertisements to people who only need cash.\(^\text{15}\) For example, a customer pays a lender a $33 fee for a $100 cash loan and promises to repay that amount in two weeks in return for the $100 and the opportunity to place an advertisement such as “Go Cowboys” in a paper circulated only to the lender’s customers.\(^\text{16}\) Once a customer obtains a loan and has difficulty repaying it, many payday lenders intimidate customers by threatening to have them prosecuted for the crime of passing bad checks because they lacked sufficient funds in their bank accounts to cover the checks.\(^\text{17}\) Many payday lenders are going beyond threats and are filing complaints with prosecuting attorneys or are having customers arrested.\(^\text{18}\) Moreover, in civil lawsuits against their customers, some payday lenders take advantage of state statutes designed to compensate victims of bad-check crimes to collect treble damages plus court costs and attorney’s fees.\(^\text{19}\) In response to complaints about the foregoing practices, payday lenders contend that these cited

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14. See Barbara A. Rehm, Tanoue Seeks to Halt ‘Renting’ of Charters to Payday Loan Firms, AM. BANKER, June 14, 2000, at 4 (“Federal Deposit Insurance Corp. Chairman Donna Tanoue . . . urged Congress to crack down on banks that are so eager for fee income they ‘rent’ their charters to payday loan companies.”), available at 2000 WL 3362278; see also discussion infra Part III.B.2.
15. See discussion infra Part I.B.2.a.
17. See discussion infra Part II.B.2.d.
18. See id.
practices are rare and are perpetrated by only a small minority of lenders.

While this Article does not conclude that every payday lender is predatory, it establishes that a large number of payday lenders engage in predatory practices. A predatory lender is one who, for personal profit, takes advantage of another by unfair, albeit technically legal, means. In this Article, payday lenders are labeled predators because they reap generous profits by taking advantage of consumers through means that are not only grossly unfair but, in many cases, also entirely unlawful. This conclusion is based on the results of a survey conducted by the author as well as investigations performed by state regulators and consumer advocacy groups. The survey conducted focused on payday lenders in Ohio (Ohio Survey) and is unique in that it is the first where surveyors actually obtained payday loans and attempted to rescind them. Contrary to the industry’s contention, the Ohio Survey


21. See, e.g., Kari Lydersen, Payday Profiteers: Payday Lenders Target the Working Poor, MULTINATIONAL MONITOR, Oct. 1, 2001, at 9 (stating that First Cash Financial Services, Inc., reported a 54% increase in profits during the first six months of 2001), available at 2001 WL 15520552; Teresa Dixon Murray, Quick Cash with a Catch, PLAIN DEALER (Cleveland), Sept. 23, 2001, at G1 (stating that the largest payday lenders reported “at least a 50 percent increase in revenues in the first half of 2001”), available at 2001 WL 20551086; Compl., Sec. & Exch. Comm’n v. Ace Payday Plus, LLC, No. 1-02-20858-Civ.-Ungaro-Benages ¶ 14 (S.D. Fla. filed Mar. 19, 2002) (asserting various violations of securities laws by Ace, the largest check-cashing company that offers payday loans, and stating that Ace’s estimated earnings from its payday loan operations to yield “an average of up to 360% profit per year” and its check cashing operations to yield “up to 720% per year”), http://www.sec.gov/litigation/complaints/complr17422.htm. Payday lenders must be earning generous profits because they are trying to attract financial investors by promising a 20% return on their investment. See, e.g., SEC Brings Emergency Enforcement Action Against Florida Check Cashing Business and Affiliates, SEC NEWS DIG., (U.S. Sec. & Exch. Comm’n, Washington, D.C.) Mar. 20, 2002, available at 2002 WL 10534114. For further discussion, see infra note 367 and accompanying text.
demonstrates widespread noncompliance with consumer protection laws and the industry's own self-regulatory guidelines. The totality of results of the Ohio Survey and other investigations clearly exposes the payday loan industry as predatory. While this Article discusses unlawful payday lending practices, other technically legal practices discussed herein frustrate the purposes of state and federal consumer protection laws even though the practices might be characterized as merely shrewd business conduct necessarily attendant to capitalism. These technically legal practices exist within loopholes that generate both excessive profits for payday lenders and adverse consumer effects entirely unintended by responsible legislative bodies. As a result, this Article concludes the payday loan industry needs to be federally regulated.

Part I of this Article explains the characteristics of a typical payday loan transaction and the characteristics of consumers in need of payday loans.\textsuperscript{22} It provides the background information necessary to appreciate why payday lending practices evoke strong condemnation from consumer protection advocates and concerned lawmakers. By refuting the frequent industry assertion that payday loans are merely services provided to consumers, Part I further establishes that payday loans are a form of consumer credit.\textsuperscript{23} The credit label is highly important. Because payday loans constitute a form of credit, borrowers should be afforded legal protections comparable to those available to users of traditional forms of consumer credit.\textsuperscript{24}

Part II of this Article describes the unfair and unlawful lending practices permeating the payday loan industry and analyzes how they violate various laws.\textsuperscript{25} Using the results of the Ohio Survey and other studies, Part II details the exorbitant interest charges payday lenders have managed to collect from their borrowers. It further describes the unlawful means employed by payday lenders to mislead consumers about

\textsuperscript{22} See discussion infra Part I.A.

\textsuperscript{23} See discussion infra Part I.B.

\textsuperscript{24} Middle- and upper-class Americans are not subject to these abusive collection practices when they default on credit card debts. Payday loan customers should receive comparable protection.

\textsuperscript{25} See discussion infra Part II.A.
the cost of credit, thereby enticing them into a loan transaction. Part II also examines common egregious practices following the consummation of the loan. These practices include "rollover" terms that trap consumers like Ortega in a permanent cycle of debt and collection practices that subject defaulting borrowers to both punitive sanctions through the imposition of treble damages and criminal sanctions through bad-check prosecutions.

Part III of this Article explains how the payday lending industry has managed to thrive despite the egregious treatment of its borrowers. This section first explores demographic data demonstrating that payday loan customers are particularly susceptible to oppressive loan terms and collection practices because they lack access to traditional forms of credit. Part III further describes how payday lenders exploit ambiguities in state law and federal banking law to take full advantage of their customers’ lack of financial options. Part III highlights the recent trend among payday lenders to use "rent-a-bank" partnerships with traditional banks to charge fees higher than those allowed by state law.

Part IV argues for a comprehensive system of federal

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26. See discussion infra Part III.B.

27. See discussion infra Part III.B.2. Payday lenders are aggressively seeking banks for partnership arrangements because, under federal banking law, a payday lender may charge interest at the maximum rate allowed by a bank’s home state, instead of being limited by a lower rate permitted in the state where the customer resides. Id. This practice, known as “rent-a-bank,” is the basis for National Money’s claim that it did not violate Texas’s fee limitation of $15.60 or rollover limitations when it collected $1800 in fees on a $300 loan to Ortega. See supra note 10 and accompanying text. Part I debunks the payday lenders’ claim that federal law preempts state usury law to the extent that the payday lender, rather than the bank, has the preponderant economic role in the payday lending operation. Federal banking regulators have warned banks about partnering with payday lenders and do not support rent-a-bank because of concerns over consumer protection issues and banking safety and soundness risks. Press Release, Office of the Comptroller of the Currency and Office of Thrift Supervision, Agencies Urge Banks and Thrifts to Evaluate Risks with Vendors Engaged in Practices Viewed as Abusive to Customers (Nov. 27, 2000) (indicating that OCC and OTS “alerted national banks and federal thrifts that the agencies have significant safety and soundness, compliance and consumer protection concerns with banks and thrifts entering into contractual arrangements with vendors to fund so-called ‘title loans’ and ‘payday loans’”), available at 2000 WL 1740418, at *1. For further discussion, see infra notes 526-30 and accompanying text.
regulations to protect consumers from the rampant overreaching that is common in today's payday loan transactions. This Article concludes with recommendations for a payday lending statute that protects consumers from predatory payday lending practices and that enables consumers to exit the subprime lending market, while protecting the legitimate interests of payday lenders.

I. THE NATURE OF PAYDAY LENDING

Payday lenders are central figures in the fringe banking industry, which has arisen to serve consumers with low-to-moderate incomes. In the book Fringe Banking: Check-Cashing Outlets, Pawnshops, and the Poor, Professor John P. Caskey first described the nationwide proliferation of fringe banks, companies that offer credit products to consumers excluded from mainstream banking services. Because of widespread bank branch closings in poor and minority neighborhoods, these consumers lack access to traditional forms of credit. Only a small number of check-cashing outlets issued payday loans when Professor Caskey wrote Fringe Banking. He stated, however, that if check-cashing outlets

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28. See infra Part IV.B (discussing the ineffectiveness of existing state law and positing that Congress needs to set minimum consumer protections). While banning payday loans is an option, it is not a viable option given the consumer demand for the loans and the aggressive lobbying efforts of payday lenders.

29. See infra notes 719-62 and accompanying text.

30. Melissa Allison, Regulators Leave Locations up to Banks, CHI. TRIB., Nov. 25, 2001, § 5, at 1. Lending volume is the primary factor dictating the number of bank branches in a given area. Id. This reality results in fewer bank branches in low-income and minority neighborhoods and more payday loan companies since payday loan companies typically cost less to operate and generate more income than a typical bank branch. Id.

31. See JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 6-7, 70-71, 90-97 (1994); Michael A. Stegman, Banking the Unbanked: Untapped Market Opportunities for North Carolina's Financial Institutions, 5 N.C. BANKING INST. 23, 28 (2001) ("The core of this 'fringe banking' industry, as it is commonly referred to by consumer advocates, is a national network of check cashing centers and payday lenders . . . .").

32. CASKEY, supra note 31, at 59. In his book, Professor Caskey describes "salary lenders," the forerunners of today's payday lenders. See id. at 31-32. In a typical arrangement, an unlicensed lender would make a loan by "purchasing" a worker's next paycheck at a discount. Id. Salary lenders claimed they were not lending but were purchasing property. Id. at 30, 32. Many states adopted small loan laws to regulate this practice. Id.
regularly issued payday loans, a strong case would exist “for fairly extensive regulations and monitoring” of check-cashing outlets. While Professor Caskey’s 1994 book did not elaborate on the point, this Article explains why he was correct to make that assertion. To appreciate why payday lending practices deserve federal regulatory supervision, one must first understand how a typical payday loan transaction operates, and, second, how these transactions qualify as a form of consumer credit rather than merely a contract for check-cashing services. In this regard, section A provides a general description of the common loan terms and a brief description of typical payday loan borrowers. Section B then explores the considerable authority that firmly establishes payday loans as a form of consumer credit.

A. WHAT ARE PAYDAY LOANS AND WHO USES THEM?

Payday loans are known by various names, including payday advances, deferred deposit loans, and cash advance loans. To apply for a loan, a consumer usually needs to present a driver’s license, pay stub, bank statement, telephone bill, and checkbook. Payday lenders advertise that consumers can obtain, in minutes, payday loans without hassles or credit checks. Assuming a consumer qualifies for a payday loan, a

33. Id. at 124 n.11.
35. This list of documents is based on the Ohio Survey results. See also Fox, supra note 12, at 989 (noting that “recent pay stubs, bank statements, photo identification, car registration, several months’ telephone bills and utility bills” are the typically required documents); Dewanna Lofton, Is It Legalized Loan Sharking, or Help for Those with Nowhere Else to Go?, COM. APPEAL (Memphis), Sept. 3, 2000, at DS1 (“Most [payday lenders] require that borrowers bring a driver’s license or state-issued photo ID, a recent pay stub, telephone bill, bank statement and checkbook with pre-printed checks.”), available at 2000 WL 24146185.
36. Drysdale & Keest, supra note 16, at 606 (“[I]t is handy, quick, and hassle-free; there are no obstacles such as bad credit records.”); Daniel A. Edelman, Payday Loans: Big Interest Rates and Little Regulation, 11 LOY. CONSUMER L. REV. 174, 174 (1999) (indicating that the lack of a credit check is a feature that “makes these loans attractive to those who have, or think they
nontraditional lender\textsuperscript{37} makes a small cash advance (ranging from $50 to $1000) to the consumer in exchange for the consumer's post-dated personal check written for the amount of the loan plus a fee.\textsuperscript{38} Instead of taking a post-dated check, some lenders require the consumer to authorize a debit to the consumer's bank account when the loan is due.\textsuperscript{39} Because the lender holds the check until the consumer's next payday, the usual term of the loan is up to two weeks.\textsuperscript{40} The lender then attempts to cash the check unless the customer repays the loan \textit{in full} and reclaims the post-dated check, pays a fee to "roll over" or extend the loan's due date for another two weeks, or, in states that prohibit rollovers, refinances the loan by paying a fee.\textsuperscript{41}

Assuming the customer cannot repay the loan by its due date and must roll over the loan, the customer pays a fee usually equal to the initial borrowing fee,\textsuperscript{42} further increasing

\textsuperscript{37} Besides companies that only issue payday loans, check-cashing outlets, retail stores, and pawn shops are also offering the loans. Fox, \textit{supra} note 12, at 989. In the Ohio Survey, a liquor store, Great Western Beverage, offered payday loans. As indicated in the introduction, traditional banks are now in the payday loan business.

\textsuperscript{38} Smith \textit{v.} Check-N-Go, Inc., 200 F.3d 511, 513 (7th Cir. 1999) ("A 'payday loan' is a short-term loan that is to be repaid on the borrower's next payday."); Drysdale & Keest, \textit{supra} note 16, at 600-01.

\textsuperscript{39} Drysdale & Keest, \textit{supra} note 16, at 601 ("Some transactions use delayed automatic debit agreements instead of checks. Deposit of the check or automatic debit is deferred for an agreed-upon time, which may be tied to the next payday (even if only a matter of days), or for a scheduled period of time up to a month.").

\textsuperscript{40} Fox, \textit{supra} note 12, at 990. Some lenders can shorten loan terms to maximize costs by taking advantage of state statutes allowing loan terms of up to one full month. Drysdale & Keest, \textit{supra} note 16, at 603-04 (explaining how lenders who would make $20 off a loan fee on a $100 loan payable in one month can make twice that if the loan term were for two weeks and the borrower rolled it over and noting that "[t]his may help explain why two weeks is the most common term for payday loans").

\textsuperscript{41} Fox, \textit{supra} note 12, at 990 ("[T]he consumer can either redeem the check with cash or a money order, permit the check to be deposited, or renew the loan by paying another fee"); see also Drysdale & Keest, \textit{supra} note 16, at 601 ("To avoid appearing to roll over the debt, the lender may ask you to take out a 'new loan,' in which case you pay the $15 fee, but write another check for $115."). The last two options are virtually indistinguishable; the distinction made here merely clarifies the later discussion, \textit{see infra} Part II.B.1.a, regarding the inadequacy of statutes that attempt to prohibit rollovers.

\textsuperscript{42} \textit{See} Paul Gores, \textit{Payday Lenders Tout New Study}, MILWAUKEE J. &
the cost of the loan. If the customer signs a debit authorization agreement, the payday lender automatically withdraws the rollover/refinance charge from the customer's bank account.\textsuperscript{43} No matter how the lender characterizes or collects the fee, the fee does not count towards the original principal, and the consumer, therefore, remains indebted until he or she pays the entire original loan in a single payment.\textsuperscript{44} In other words, lenders do not accept partial payments, which explains why Ortega still owed $300 even though she paid National Money Service $1800 in rollover fees.\textsuperscript{45} The rollover practice will be addressed later in Part II.B.1. Given such payment terms, one may wonder what type of consumer chooses payday loans.

While borrowing against future income represents a common practice in America, payday lenders serve a unique class of consumers lacking sufficient income to cover financial needs.\textsuperscript{46} Part III discusses these consumers in depth. For now, realize that payday loan customers, like many Americans, possess limited incomes and no savings, but they are a distinct subset of the populous because they lack access to traditional forms of credit.\textsuperscript{47} Turned down for credit or owning maxed-out credit cards, they also have no homes and thus cannot get an equity line of credit to cover expenses.\textsuperscript{48} Many have damaged credit histories for any number of reasons, including a previous bankruptcy filing.\textsuperscript{49} These consumers can turn to nonbanks that stand ready to meet their need for short-term credit. As explained below, it is clear these consumers approach payday loans.

\begin{quote}
\textsuperscript{43} Drysdale & Keest, supra note 16, at 601. Recall Leticia Ortega who had her bank account debited $90 every two weeks for almost a year by National Money Service in order to roll over the loan. \textit{See supra} notes 1-10 and accompanying text.

\textsuperscript{44} Kathleen E. Keest, \textit{Stone Soup: Exploring the Boundaries Between Subprime Lending and Predatory Lending}, in \textit{CONSUMER FINANCIAL SERVICES LITIGATION} 2001, at 1107, 1115, (PLI Corporate Law & Practice Course, Handbook Series B-1241, 2001) ("Since the fees are flat fees, and the loans are nonamortizing, the fees pile on and on, while the principal remains untouched."). \textit{available at} WL 1241 PLI/Corp 1107.

\textsuperscript{45} Geller, \textit{supra} note 2.

\textsuperscript{46} See, \textit{e.g.}, Shaun Scafer, \textit{Lenders Thrive on Debt Cycles}, \textit{TULSA WORLD}, Jan. 28, 2002, at 1 (quoting a payday loan customer who stated that she could trace the eight payday loans that she had obtained back to shortly after her fifteen-year marriage ended), \textit{available at} 2002 WL 7106735.

\textsuperscript{47} \textit{See infra} notes 537-47 and accompanying text.

\textsuperscript{48} \textit{See infra} notes 538-46 and accompanying text.

\textsuperscript{49} \textit{See infra} note 540 and accompanying text.
\end{quote}
lenders seeking extensions of credit.\textsuperscript{50} Ample legal authority buttresses this conclusion.

**B. Payday Loans: Ordinary Check-Cashing Services or Lending Money?**

Originally earning most of their income by charging "unbanked"\textsuperscript{51} consumers fees to cash checks, check-cashing companies started to expand their operations in the early 1990s by issuing payday loans to consumers who had bank accounts with relatively low balances.\textsuperscript{52} When charged with lending without a license and evading usury laws, check-cashers initially denied that they were issuing loans.\textsuperscript{53} Consider the following example of a typical payday loan transaction. Assume Mary, who needs $100 until her next payday, visits a nearby check-cashing store. After Mary produces proper documentation, the check-casher gives Mary $100, takes from

\begin{itemize}
\item \textsuperscript{50} See infra Part I.B.
\item \textsuperscript{51} The "unbanked" are consumers who do not use regular bank accounts to pay bills or to handle other personal financial matters. See \textit{Caskey}, supra note 31, at 84-90. A large number of unbanked individuals receive governmental benefits, such as welfare and social security checks. \textit{Joseph A. Smith, Jr., Savings for the Poor: The Hidden Benefits of Electronic Banking, 5 N.C. Banking Inst. 1, 4 (2001)} (stating that the "universe of unbanked Americans, both recipients and nonrecipients of federal benefits, represents one third of all minority households").
\item \textsuperscript{52} See \textit{Jarret C. Oeltjen, Florida Pawnbroking: An Industry in Transition, 23 Fla. St. U. L. Rev. 995, 1002-03 (1996)} (discussing new pawnshop services, including "advancing money on personal checks under the guise of check cashing"); \textit{Amy Pyle, Consumer Groups Attack "Payday Loan" Business, L.A. Times, Feb. 11, 1999, at A1} (stating that check-cashers began issuing payday loans in order to replace lost profits arising from federal laws mandating that government checks (e.g., welfare or social security checks) be electronically deposited), \textit{available at 1999 WL 2128989}; \textit{Moss, supra note 12, at 3} (inferring that the market for payday loans are consumers who have small checking account balances).
\item \textsuperscript{53} See, e.g., \textit{Hamilton v. York, 987 F. Supp. 953, 955 (E.D. Ky. 1997)} (conveying a payday lender's argument "that it was not charging interest but only service fees for cashing checks"); \textit{Keest, supra note 44, at 1116-17} ("[T]he industry took the position these [payday loan transactions] were not loans, and therefore not subject to state licensing laws, state credit laws, nor Truth in Lending disclosure requirements."); \textit{Deborah A. Schmedemann, Time and Money: One State's Regulation of Check-Based Loans, 27 WM. MITCHELL L. Rev. 973, 978 (2000)}; \textit{Jeff Gelles, The Philadelphia Inquirer Consumer Watch Column, THE PHILA. INQUIRER, Nov. 14, 2001} (stating that some lenders were "drawing up a contract that says a consumer is 'leasing' the money, not borrowing it"), 2001 WL 30265902.
\end{itemize}
PAYDAY LOANS

her a postdated check for $115 (or for $100, if she pays the $15 fee in cash), and requires her to sign a contract obligating her to repay the loan in two weeks. It seems incredible that a check-casher would contend that transactions like the one in which Mary engaged in are not loans. Payday loans could be characterized as a sham transaction; that is, a transaction meant to disguise the lending of money without a license and lending at an unlawful rate of interest. Once regulators began enforcing the laws against payday lenders, some lenders began complying with state and federal law. Other lenders began adding a new feature to the transaction; they claimed they were leasing appliances or selling merchandise or services. As explained below, payday lenders have been issuing and continue to issue loans, using a variety of artifices. As a result, a plethora of federal and state laws regulating consumer credit transactions apply to payday lenders.

1. Payday Loans Are Covered by the Truth in Lending Act

The most significant law that payday lenders violate is the federal Truth in Lending Act (TILA). Passed in 1968 as Title I of the Consumer Credit Protection Act, TILA is the "cornerstone of consumer credit legislation." In Mourning v.

54. See, e.g., CASKEY, supra note 31, at 30 ("Such an agreement is obviously a short-term consumer loan, but some check-cashers claim that it is merely a delayed check-cashing transaction and should not fall under the laws governing consumer loans."); Schmedemann, supra note 53, at 978 ("The check-based loan industry [in Kentucky] maintained that the transactions were not, from a legal standpoint, loans, and the fees charged were not interest."); Helen Huntley, Tallahassee, Fla.-Based Payday Loan Firm Loses Fight in Court, ST. PETERSBURG TIMES, Jan. 26, 2000, at 1 (indicating the general counsel for the comptroller's position that "[i]f the transaction continues beyond the one payment, it's a loan, not a one-time check cashing thing"), available at 2000 WL 10327014.

55. See Drysdale & Keest, supra note 16, at 604-05 (indicating that payday loans appeared illegally in the 1980s). Illegal lenders, those operating without a license, can be found all over the country. See, e.g., Jill Taylor, Check-Casher Arrested over Interest Rates, PALM BEACH POST, May 22, 1999, at D2, available at 1999 WL 1758992.

56. See infra Part I.B.2.

57. See, e.g., infra Part I.B.1 (TILA); infra note 139 (several state statutes).


59. James P. Nehf, Effective Regulation of Rent-to-Own Contracts, 52 OHIO ST. L.J. 751, 758 (1991). Some state laws incorporate some provisions of TILA in their unfair and deceptive trade practices statutes, which are
Family Publications Service, the United States Supreme Court noted that Congress, after years of study and debate, concluded that consumers were "ignorant of the nature of their credit obligation and of the costs of deferring payment." To remedy such ignorance, Congress enacted TILA for the purpose of "assur[ing] a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit." Primarily a credit disclosure statute, TILA does not generally regulate what terms a creditor must offer, but requires that those terms, whatever they are, be uniformly disclosed to the consumer.

TILA's language supports the conclusion that payday lenders are subject to TILA's disclosure requirements because they are creditors that regularly issue "consumer credit." patterned after the Federal Trade Commission Act. See generally 2 RALPH C. CLONTZ, JR., TRUTH-IN-LENDING MANUAL: TEXT AND FORMS § 10.17, 10-102 (rev. ed. 2001) (stating that "many states have what is called the 'Little FTC Act', patterned after the Federal Trade Commission Act").

411 U.S. 356, 363 (1973). The Court also stated, Because of the divergent, and at times fraudulent, practices by which consumers were informed of the terms of the credit extended to them, many consumers were prevented from shopping for the best terms available and, at times, were prompted to assume liabilities they could not meet. Joseph Barr, then Under Secretary of the Treasury, noted in testifying before a Senate subcommittee that such blind economic activity is inconsistent with the efficient functioning of a free economic system such as ours, whose ability to provide desired material at the lowest cost is dependent on the asserted preferences and informed choices of consumers. Id. at 363-64 (footnote omitted).


See DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW 419 (2d ed. 1998) (stating that TILA is not a usury statute because "nowhere in the statute are rates set").

Under the plain language of TILA, companies that offer payday loans are subject to TILA's disclosure requirements. TILA requires "creditors," see 15 U.S.C. § 1602, to disclose the cost of credit as a dollar amount (referred to as the "finance charge" under § 1605(a)) and as an APR, see id. § 1606(a). A creditor is one who "regularly extends consumer credit." 12 C.F.R. § 226.2(a)(17) (2002). Regulation Z clarifies that one regularly extends consumer credit if one does so more than twenty-five times a year or more than five times a year for transactions secured by a dwelling, or when one extends a single credit that would be classified as a "high cost" mortgage transaction by Regulation Z. Id. § 226.2(a)(17) n.3. Payday lenders meet the second part of the definition because they require consumers to make their post-dated checks payable to the lenders, and the written contracts provide the same. The first part of the definition requires that the creditor regularly extend consumer credit that is subject to a finance charge. Payday lenders easily meet this definition because thousands of them issue at least 100 loans
per month, and the industry is predicted to issue about 180 million loans in the year 2002, grossing a profit of $45 billion. Jean Ann Fox & Edmund Mierzwinski, Rent-A-Bank: How Banks Help Payday Lenders Evade State Consumer Protections, the 2001 Payday Lender Survey and Report, (CFA & State Public Interest Research Groups), at http://www.uspirg.org/reports/rentabank/paydayreportnov13.pdf, at 4 (Nov. 2001) (noting that “12,000 to 14,000 stores make 100 or more loans per month”); John Reosti, As Others Retreat, Delaware Bank Cashes in on Payday Lending, AM. BANKER, Aug. 16, 2001, at 1, available at 2001 WL 26573247. In addition to meeting the regularity requirement, payday lenders offer loans that are subject to a finance charge because the loans carry a service charge. Examples of charges that qualify as a finance charge include a “[s]ervice or carrying charge.” See 15 U.S.C. § 1605(a).

64. Payday loans are “consumer credit” transactions. “Credit” is the “right to defer payment of debt or to incur debt and defer its payment.” 12 C.F.R. § 226.2(a)(14). Based on the plain language of the statute and Regulation Z, payday lenders are extending credit because they give the consumer the right to defer repayment of the money received until her next payday. An extension of credit qualifies as “consumer credit” when the creditor extends the credit to a natural person who uses the loan proceeds primarily for personal, family, or household purposes. Id. § 226.2(a)(12). Payday lenders extend consumer credit because they allow the cash to be used to cover personal financial problems. One can easily conclude this is true by simply looking at any payday lender's brochure, advertisement, or website. This is especially true given the inclination of the courts to liberally construe TILA. Begala v. PNC Bank, 163 F.3d 948, 950 (6th Cir. 1998) (“We have repeatedly stated that TILA is a remedial statute and, therefore, should be given a broad, liberal construction in favor of the consumer.”); Fairley v. Turan-Foley Imps., Inc., 65 F.3d 475, 479 (5th Cir. 1995) (“Consistent with its purpose, [TILA] is meant to be construed liberally in favor of the consumer.”); Jackson v. Grant, 890 F.2d 118, 120 (9th Cir. 1989) (adopting a liberal construction for TILA). Payday lenders advertise how the consumer can use the payday loan to cover personal matters such as paying utility bills, and the lenders do not ask why the loan is needed. For example, Check$mart's website contains the following advertisement:

At Check$mart we will pay up to $500 against your personal check!
So you can get that cash you need today for:
• Bills (utilities, credit cards, medical, etc. . . .)
• Grocery Shopping
• Car Repairs
• Rent or Mortgage
• Car or Home Repairs
• Clothing
• Vacation
• Emergencies
Check$mart never asks you to explain the reason why you need the cash.

Check$mart website, at http://www.checksmart.com (last visited Aug. 16, 2001); see also Check into Cash website, at http://www.checkintocash.com/how_it_works.htm (last visited Aug. 16, 2001) (“Check into Cash is perfect for times when your budget is stretched by unexpected expenses. Such as . . . car repairs, medical expenses, home emergencies, or maybe you're just trying to get in on a great sale.”).
Despite TILA's plain language, payday lenders initially contended that they were not extending consumer credit but were merely providing check-cashing services and, therefore, were not subject to TILA. With one exception, courts addressing the issue have held that payday loans are extensions of credit under TILA. In Hamilton v. York, the court deemed that these “check-cashing” services were “nothing more than interest bearing loans,” and found it difficult “to imagine how charges for exchanging money today for more money at a later date could be classified as anything but interest on a loan.”

Congress authorized the Federal Reserve Board to issue regulations implementing TILA. In 2000, the Federal Reserve Board revised its Official Staff Commentary to Regulation Z to clarify that payday loans constitute “credit” for

65. Professor Deborah A. Schmedemann explains the distinction between check cashing and payday loans as follows:

Check cashing typically involves a check written by an employer or government welfare fund to the customer; [payday] loans involve a check written by the borrower to the lender. Check cashers present the checks they receive for payment; in the typical [payday] loan, the lender intends not to present the check to the borrower's bank. Check cashing does not entail an ongoing obligation on the part of the customer; [payday] loans do. Finally, the fees paid differ significantly: a single fee of, say, ten percent for standard check-cashing transactions versus an on-going fee at an annual rate of over 500%.

Schmedemann, supra note 53, at 976 (footnote omitted).


purposes of TILA. If a fee charged in connection with a payday loan meets the definition of a “finance charge” under TILA, the Official Staff Commentary ignores the characterization of the fee under state law. Moreover, “[p]ersons that regularly extend payday loans and otherwise meet the definition of [a] creditor . . . are required . . . to provide disclosures to consumers consistent with the requirements of Regulation Z.” Because courts treat the Official Staff

69. Open-End Credit, 65 Fed. Reg. 17,129 (Mar. 31, 2000) (to be codified at 12 C.F.R. pt. 226). The new comment appears at Reg. Z § 226.2(a)(14)-2. Id. at 17,130. Congress gave authority to the Federal Reserve Board to issue regulations implementing TILA. 15 U.S.C. § 1607(d). Accordingly, the Federal Reserve Board promulgated Regulation Z, which prescribes the form, content, and timing of the disclosures required by the TILA. See 12 C.F.R. §§ 226.1-.33 (2001). The Federal Reserve Board has also issued official commentary on Regulation Z. 12 C.F.R. § 226 (2002). The requirements of Regulation Z are deemed requirements of TILA. 15 U.S.C. § 1602(y); London v. Chase Manhattan Bank USA, N.A., 150 F. Supp. 2d 1314, 1322 (S.D. Fla. 2001) (“[A]s is fully apparent from the text of § 1602(y) of TILA, Congress intended that those regulations, which subsequently were promulgated as Regulation Z, would be authoritative respecting the implementation of TILA’s disclosure provisions.”). Unless a provision of Regulation Z contradicts TILA, courts accept as authoritative the Federal Reserve Board’s regulatory implementation of TILA as well as its interpretation of its own Regulation Z. Anderson Bros. Ford v. Valencia, 452 U.S. 205, 219 (1981) (citing Ford Motor Credit Co. v. Milhollin, 444 U.S. 555, 570 (1980) and stating, “[A]bsent some obvious repugnance to [TILA], the Board’s regulation implementing [TILA] should be accepted by the Courts, as should the Board’s interpretation of its own regulation.”); Milhollin, 444 U.S. at 566 n.9 (noting that Congress has conferred "special status upon official staff interpretations" of Regulation Z).

70. See Open End Credit, 65 Fed. Reg. 17,129.

71. Id. at 17,130. The full comment reads as follows: Payday loans; deferred presentment. Credit includes a transaction in which a cash advance is made to a consumer in exchange for the consumer’s personal check, or in exchange for the consumer’s authorization to debit the consumer’s deposit account, and where the parties agree either that the check will not be cashed or deposited, or that the consumer’s deposit account will not be debited, until a designated future date. This type of transaction is often referred to as a “payday loan” or “payday advance” or “deferred presentment loan.” A fee charged in connection with such a transaction may be a finance charge for purposes of § 226.4, regardless of how the fee is characterized under state law. Where the fee charged constitutes a finance charge under § 226.4 and the person advancing funds regularly extends consumer credit, that person is a creditor and is required to provide disclosures consistent with the requirements of Regulation Z.

Id. at 17,131. The Federal Reserve Board’s commentary accords with several states that regulate payday lending and already require lenders to provide TILA disclosures. Id.
Commentaries as law, payday lenders must comply with the disclosure requirements of TILA.

2. Disguising Payday Loans Through Sham Transactions

To skirt TILA's disclosure requirements, some payday lenders cloak the payday loan transaction with alternative lending schemes. Critics claim that, besides violating TILA, these lenders violate state laws by not complying with state usury limits, by failing to obtain licenses to issue consumer loans, by failing to pay state and local taxes, and by failing to comply with state credit disclosure requirements. Following a description of popular alternative lending transactions, this section analyzes whether these transactions are "loans" or "credit" transactions subject to federal and state laws.

a. Leasing Appliances or Selling Goods and Services

One popular scheme is the sale-leaseback transaction. In this exchange, the lender "buys" a consumer's household appliance and then leases it back to the consumer for a rental fee until the consumer can repurchase it. The appliance, however, is never actually delivered to the lender. Instead,
the lender gives the consumer cash and takes only a post-dated check from the consumer as security.\textsuperscript{79} Even though sale-leaseback companies claim they are not lenders, they advertise along with traditional lenders in the loan section of local yellow pages.\textsuperscript{80} In a 2001 survey of payday lenders in Texas, Consumers Union found sale-leaseback lenders charging consumers rental rates as low as $18.40 and as high as $64.94 for a two-week loan of $100.\textsuperscript{81} Moreover, Consumers Union found that fourteen out of the twenty-one companies surveyed offered sale-leaseback services and ten out of those fourteen specifically claimed the service was “not a loan.”\textsuperscript{82} The average fee for the sale-leaseback service was $33 (or an effective APR of 832\%) for a $100 two-week loan.\textsuperscript{83}

The Texas Committee on Economic Development’s Subcommittee on Consumer Credit Laws recently investigated companies offering sale-leaseback loans and concluded that these companies “embrace the subterfuge of renaming the loan transaction in order to avoid regulatory oversight.”\textsuperscript{84} If the customer is unable to repay the loan, the companies do not take the property but only accept payment of a lease renewal fee.\textsuperscript{85} As with regular payday loans, some customers of sale-leaseback companies find themselves caught in a vicious cycle of debt.\textsuperscript{86}

In addition to offering sale-leaseback services, some payday lenders operate “cash catalog sale” companies. This type of scheme has surfaced in several states, including Alabama, Florida, Georgia, Nevada, and Texas.\textsuperscript{87} By

\begin{itemize}
\item \textsuperscript{79} Guerra, supra note 78, at B1.
\item \textsuperscript{80} Id.
\item \textsuperscript{81} Id.
\item \textsuperscript{82} Id.
\item \textsuperscript{83} Id.
\item \textsuperscript{84} Tim Morstad, Sale-Leaseback Lenders Defy Regulation, CONSUMERS UNION, Feb. 2001, at 4. It should be noted that sale-leaseback transactions are not limited to appliances. Drysdale & Keest, supra note 16, at 598 n.38 (discussing sale-leaseback schemes involving automobiles and homes).
\item \textsuperscript{85} Cardella, supra note 77, at 3.
\item \textsuperscript{86} For example, one customer filed a complaint with Texas’s Office of Consumer Credit Commissioner stating that, after he “sold” his VCR and television to more than one sale-leaseback company, he paid, over a five-month period, in excess of $3797 to repay eight loans totaling $1853. Id. at 3.
\item \textsuperscript{87} Patricia Dedrick, Montgomerian Attempts to Join Suit to Regain Fees, MONTGOMERY ADVERTISER, Jan. 11, 1999, at B6, 1999 WL 10343501; Firms Accused of Duping Sailors, FLA. TODAY, Oct. 6, 1996, at B2, 1996 WL
\end{itemize}
advertising in the loan section of the yellow pages,\(^{88}\) and by operating under names such as Instant Cash Catalog Sales\(^ {89}\) and Money Express Catalog Sales Inc.,\(^ {90}\) catalog sale companies do not try to hide their status as payday lenders. Catalog sale companies require a borrower to purchase catalog certificates in order to obtain a loan.\(^ {91}\) In exchange for cash, the borrower writes a check for the amount of the loan plus the cost of the catalog certificates.\(^ {92}\) For example, the borrower writes a $130 check for a $100 loan, with the additional $30 supposedly in consideration for the certificates. When the loan becomes due, the catalog company cashes the check and gives the borrower the certificates.\(^ {93}\) In theory, the borrower may then use the certificates to purchase merchandise from the company’s catalog.\(^ {94}\) In *Cashback Catalog Sales v. Price*, however, the court noted that the certificates at issue could only be used to purchase items from a mail-order catalog that was never given to the consumer.\(^ {95}\)

Additionally, like cash-back catalog companies that issue potentially worthless certificates, some payday lenders have created cash-back advertisement companies that print useless advertisements.\(^ {96}\) Consumers needing cash can find the nearest cash-back advertisement company in the loan section of the yellow pages\(^ {97}\) and go there to borrow $100 by purchasing

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\(^{88}\) *Cashback Catalog Sales*, 102 F. Supp. 2d at 1377 (“Cashback maintains an advertisement in the local yellow pages under the subject heading ‘Loans.’”).

\(^{89}\) Cardella, *supra* note 77, at 2.

\(^{90}\) Nevada Licensees, *supra* note 87.

\(^{91}\) Cardella, *supra* note 77, at 2.

\(^{92}\) Smith, *supra* note 51, at 29 n.13.

\(^{93}\) Id.

\(^{94}\) Id.

\(^{95}\) *Cashback Catalog Sales*, 102 F. Supp. 2d at 1380.


\(^{97}\) For a discussion of a lawsuit pending against one payday lender offering cashback advertisements, see *Payday Lending Class Action Certified in Texas*, 10 CONS. BANKR. NEWS 14 (2000), 10 No. 5 CBN (LRP) 14 (citing
an advertisement for publication and paying a $33 advertisement fee.\textsuperscript{98} Usually, the consumer has nothing to advertise; however, companies insist upon the purchase of an advertisement before distributing any cash. These ads are then placed in a publication distributed by the lender to its customers.\textsuperscript{99} The consumer must also issue a check as security for repayment of the loan.\textsuperscript{100} If the consumer is unable to repay the loan when due, the consumer must renew the loan by purchasing another ad and paying an additional fee.\textsuperscript{101}

\textit{b. Sham Transactions Are Usurious Extensions of Credit}

Arguably, the disguised payday loan companies are simply selling a service or product and, therefore, their transactions are distinguishable from regular payday loans. In fact, when the Federal Reserve Board revised the term "credit" to include payday loans,\textsuperscript{102} some advocates feared that the proposed comment would be limited to transactions thus labeled.\textsuperscript{103} The Board made clear, however, that "[t]ransactions in which the parties agree to defer payment of a debt are 'credit' transactions regardless of the label used to describe them."\textsuperscript{104} Therefore, offering a service or product in conjunction with a payday loan should not prevent the transaction from being defined as a consumer credit transaction.\textsuperscript{105}

In \textit{Cashback Catalog Sales}, the defendant, Cashback, argued that it had not extended credit for purposes of TILA when it took a customer's $130 post-dated check—$100 for the loan and $30 for the catalog certificates.\textsuperscript{106} Denying Cashback’s motion for summary judgment, the court held that a reasonable trier of fact could find that Cashback extended "credit" when it

\textsuperscript{98} Cardella, \textit{supra} note 77, at 3.
\textsuperscript{99} Drysdale & Keest, \textit{supra} note 16, at 604.
\textsuperscript{100} Cardella, \textit{supra} note 77, at 4.
\textsuperscript{101} \textit{Id.}
\textsuperscript{104} \textit{Id.}
\textsuperscript{105} Conditioning the extension of credit on a consumer’s purchase of an unwanted item or service has long been held to be clear evidence of a lender’s intent to evade usury laws. See, e.g., People v. Coleman, 59 N.W.2d 276, 277 (Mich. 1953) (concluding that conditioning the receipt of a loan on the purchase of unwanted vitamins was an attempt to secure interest rates higher than those allowed by the law).
\textsuperscript{106} \textit{Cashback Catalog Sales}, 102 F. Supp. 2d at 1376.
promised not to cash the post-dated check until the customer's next payday, assessed a "finance charge" when it required the post-dated check to include the cost of the catalog certificates, and operated as a "creditor" when it regularly had customers make the post-dated checks payable to Cashback. Consequently, upon meeting the relevant statutory definitions, a cashback catalog company is subject to TILA’s disclosure requirements.

In addition to being subject to TILA, cashback catalog companies are subject to state usury laws. In Cashback Catalog Sales, the court found that a loan existed because Cashback agreed to hold the customer's check until his next payday and the customer had an obligation to repay the money received. Cashback argued that the catalog certificates given to the customer did not constitute interest. The plaintiff countered that the $30 certificates constituted a finance charge amounting to an APR of 780% for a $100 two-week loan; Georgia, home to Cashback's operations, caps the legal interest rate for loans less than $3000 at 16% per year. Agreeing with the plaintiff, the court explained that substance must prevail over form. The court concluded that the certificates

107. Id. at 1381-82.
108. Id. at 1381.
109. To establish a usury claim under Georgia law, a plaintiff needs to prove four elements: (1) a loan or forbearance of money, either express or implied; (2) an understanding that the principal must be repaid; (3) an agreement to pay in return for such loan or forbearance a greater profit than is authorized by law; and (4) that the contract was made with an intent to violate the law. Id. at 1379. To establish a violation of Florida usury laws, a borrower must establish the following elements by clear and satisfactory evidence: (1) a loan, express or implied; (2) an understanding between the parties that the money lent shall be repaid; (3) that a greater rate of interest than is allowed by law was paid or agreed to be paid; and (4) the corrupt intent of the lender to exact more than the legal rate of interest.
110. Cashback Catalog Sales, 102 F. Supp. 2d at 1380.
111. Id. at 1379.
113. Cashback Catalog Sales, 102 F. Supp. 2d at 1380. The Court
constituted usurious interest, noting the lack of an order form or any material about actually ordering merchandise. The court further stated that “check cashing” appeared to be the main purpose of the contract and questioned whether the catalog certificates would ever be redeemed.

The holding in *Cashback Catalog Sales* should not be confined to payday loan transactions involving catalog certificates. The holding should apply to similarly disguised payday loan transactions. Take for instance, payday loan transactions involving the “leasing” of an appliance or “selling” of an advertisement. Companies that engage in these transactions act much like regular payday lenders. First, they advertise their business in the loan section of yellow pages. Second, they take post-dated checks from their customers. Third, they distribute cash immediately to their customers. Fourth, they agree not to cash their customers' checks for two-weeks. Finally, they demand fees that amount to triple-digit interest rates for their services or merchandise.

Payday loans exceed interest rate caps in states lacking laws regulating payday lending as well as those states regulating the industry because disguised payday loans carry triple-digit APRs. Two facts support this conclusion. First, disguised payday loans may carry an APR of 792% or more, but state usury laws typically limit APRs to double-digit interest rates.

No disguise of language can avail for covering up usury, or glossing over an usurious contract. The theory that a contract will be usurious or not according to the kind of paper-bag it is put up in, or according to the more or less ingenious phrases made use of in negotiating it, is altogether erroneous. The law intends that a search for usury shall penetrate to the substance. *Id.* (quoting *Pope v. Marshall*, 4 S.E. 116, 118 (Ga. 1887)).

114. *Id.* at 1380.
115. *Id.* Although the court does not expressly say so, “check cashing” can refer to payday loans. *See Schmedemann, supra note 53,* at 974 (suggesting that the term “check cashing” is commonly used to describe payday loans).
116. *See supra* notes 76-86, 96-101 and accompanying text.
117. Cardella, *supra* note 77, at 2, 5. In a 1999 survey of twenty-seven regular and disguised payday lenders in Texas, Consumers Union found that for every $100 cash advanced per loan period (fourteen or fifteen days), nineteen lenders charged fees of at least $33, six lenders charged $30, and two lenders charged under $30. *Id.* at 5. Based on these fees, twenty-five of the twenty-seven companies are lending money over a fourteen-day or fifteen-day period at APRs of approximately 792%. *Id.*
118. *See, e.g.,* GA. CODE ANN. § 7-4-2(a)(2) (1997) (indicating that the maximum interest rate is 16% per year for loans of less than $3000); IND.
District of Columbia regulate payday lending and allow triple-digit interest rates, only one of these states allows fees amounting to an APR in excess of 792%, and the majority require that APRs remain below 469%. Given the outrageous APRs of payday lending schemes, lawmakers should not rely on judicial decisions alone to determine if future schemes are covered by consumer protection laws. The burden on the judicial system is already enormous. Therefore, efficiency dictates that state lawmakers enact statutory provisions that broadly define "loans" or "credit" and thereby strip payday lenders of any legal

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119. Cardella, supra note 77, at 2, 5.
120. See Fox & Mierzwinski, supra note 63, at 27-29; Miller, supra note 20, at 121-22.
121. Payday lenders continue to fabricate new schemes to evade the law. E-mail from Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, to Creola Johnson, Assistant Professor of Law, The Ohio State University Moritz College of Law (Oct. 1, 2001, 10:36 EST) (describing an installment loan program being offered by Americash to consumers in Chicago) (on file with author).
122. Courts may fail to properly interpret or liberally construe a state consumer protection statute, and, as a result, leave a consumer without a viable cause of action under state law. For example, in King v. Cashland, Inc., the plaintiff asserted an unfair and deceptive act claim against a payday lender under the Ohio Consumer Sales Practices Act (OCSPA), OHIO REV. CODE ANN. § 1345.02(A) (Anderson 2002). No. 18208, 2000 Ohio Ct. App. LEXIS 3943, at *3, 10 (Ohio Ct. App. Sept. 1, 2000). As with every consumer protection statute, from which certain entities are exempt, the OCSPA does not regulate transactions with a "dealer in intangibles," which includes an entity in the business of lending money. OHIO REV. CODE ANN. §§ 1345.01(A), 5725.01(B). In Cashland, the court held that the defendant, Cashland, was a dealer in intangibles as defined by Ohio law. 2000 Ohio Ct. App. LEXIS 3943, at *12. The court merely noted, but did not directly address, the fact that the Ohio payday lending statute expressly gives a consumer a cause of action under the OCSPA if the payday lender violates section 1315.41 of the payday lending statute. Id. at *13 n.5; see also OHIO REV. CODE ANN. §§ 1315.41, -44. Due to the express reference, the court should have concluded that the Ohio Legislature stripped the payday lender of an exemption defense under the OCSPA. See Helman v. EPL Prolong, Inc., 743 N.E.2d 484, 494 (Ohio Ct. App. 2000) ("[I]t is settled that specific statutory provisions prevail over conflicting general provisions unless the legislature's intent that the general prevail is clear.").
123. See William M. Richman & William L. Reynolds, Elitism, Expediency, and the New Certiorari: Requiem for the Learned Hand Tradition, 81 CORNELL L. REV. 273, 332 n.283 (1996) (stating that "state courts are even more overloaded than their federal counterparts" because "[s]tate courts handle 52 times the caseload with only 15 times the judges").
defense for their disguised payday loans.\footnote{See infra Part IV.B for a discussion about the necessity of comprehensive legislation to deal with predatory payday lending practices.}

In summary, payday lending superficially appears grounded on a straightforward and seemingly innocuous concept. Consumers sometimes need extra cash to get by for a week or two, and check-cashers have stepped in to meet this demand. They do so by simply agreeing to hold onto the customer's personal check until the customer's next payday. In exchange, the borrower agrees to pay a fee larger than the typical check-cashing fee associated with a check of that size.\footnote{See Schmedemann, supra note 53, at 976 (explaining the differences between check cashing and payday lending).} As evident by the rapid growth of the payday loan industry, these fees have translated into generous profits.\footnote{See supra note 21 (discussing the payday loan industry's high profitability).}

Accordingly, it is not surprising that payday lenders have resisted disclosing the APRs of their loans. As the next section demonstrates, the APRs on payday loans far exceed those allowed for any other form of personal consumer credit. Payday lenders, therefore, possess a strong economic incentive to avoid disclosing their finance charges in a way that allows consumers to compare the cost of one credit transaction to another. The industry's creativity in characterizing payday loans as anything but credit extensions stems directly from this incentive. Unfortunately, the industry's quest to protect its profits extends beyond merely engaging in sham transactions. Part II reveals the industry's desire to protect its profits extends far beyond legal and ethical boundaries.

\section*{II. CRITICISMS OF THE PAYDAY LOAN INDUSTRY}

The sham transactions discussed above represent practices employed by payday lenders to deceive regulators and evade consumer protection laws. This section identifies payday lending practices that deceive and exploit consumers by means that are quintessentially unfair to consumers and also often illegal. The practices include charging fees amounting to triple-digit APRs, distorting information relevant to assessing the cost of credit, charging high fees to roll over payday loans, refusing to honor representations that consumers have the
right to rescind at no cost, seeking treble damages from customers in default, and threatening delinquent customers with criminal prosecution. Section A analyzes unfair and unlawful payday loan practices occurring before or during contract formation. Section B continues this analysis with a focus on payday loan practices occurring post contract formation.

A. UNFAIR AND UNLAWFUL PRACTICES BEFORE OR AT CONTRACT FORMATION

As explained below, the results of various studies show that payday lenders charge enormous fees, sometimes in violation of state law.127 This practice, coupled with other practices such as seeking treble damages and criminal prosecution,128 leads many critics to conclude that payday lenders are nothing more than loan sharks or predatory lenders exploiting vulnerable consumers.129 The Ohio Survey conducted by the author confirms these conclusions. The survey results reveal that the majority of lenders surveyed mislead consumers about the cost of payday loans.

1. The Cost of Payday Lending: Triple-Digit Interest Rates

Customers who obtain payday loans pay fees amounting to effective APRs usually totaling several hundred percent.130 For

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127. See infra Part II.A.1.
128. See infra Part II.B.2.
129. See, e.g., Marcy Gordon, High-Interest Lender Regs Nixed, ASSOCIATED PRESS, Feb. 2, 2000 (quoting Minnesota Senator Paul Wellstone, a Democrat, who stated that payday lenders are “unscrupulous loan sharks”), available at 2000 WL 12387086; Gwyneth K. Shaw, Lobbyists Push for Tougher Loan Bill, SUN-SENTINEL (Ft. Lauderdale), May 4, 2000, at 10B (quoting a Florida politician who stated that he would wait another year to attack payday lending rather than “legitimize loan-sharking in this state”), available at 2000 WL 5657043; Kevin Valine, Quick Cash at a Price, SARASOTA HERALD-TRIB., May 15, 2000, at 12 (stating that Florida Legal Services will fight to protect consumers from predatory payday lenders), available at 2000 WL 16699392; Wheat Urges Response to 'Predatory' Lenders, CREDIT UNION J., Feb. 14, 2000, at 14 (describing a board member of a national credit union organization who urged credit unions to help tighten the reigns on payday lenders because they are “predatory lenders, financiers that provide ready loans at high interest rates”), available at 2000 WL 18823239.
130. Elizabeth Renuart & Jean Ann Fox, Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities, 34 CLEARINGHOUSE REV. 589, 589 (2001) (“The typical annual percentage rate is at least 390 and
example, in a 1999 survey of 230 payday lenders in twenty states, the Consumer Federation of America (CFA) found lenders making payday loans of $100 to $400 at interest rates of 390% to 871%. In its 2001 survey, the CFA found one-third of the 235 payday lenders surveyed charged an APR greater than 500% for a fourteen-day, $100 loan. The CFA reported an average APR of 470% for all states surveyed for the same loan.

Currently, the maximum fee to allowed payday lenders depends on the state law governing the transaction. Four states—Idaho, New Hampshire, New Mexico, and Wisconsin—have no interest rate or usury caps on small loans. Therefore, a licensed payday lender and the consumer can contract at interest rates that far exceed small loan caps. The CFA's 2001 survey discovered an average APR of 504% in two states lacking usury limits.

When it surveyed lenders in thirteen states where payday lending is legal, the CFA uncovered an average APR of 443%. As of this writing, twenty-nine states and the District of Columbia expressly authorize payday lending, and the majority limit the size of the loan and the interest rates or fees averages close to 500 percent, although advocates and credit code enforcement agencies have noted rates of 1,300 percent to 7,300 percent.

131. STATE PUB. INTEREST RESEARCH GROUPS & CONSUMER FED. OF AM., SHOW ME THE MONEY! A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES 1 (2000), at http://www.pirg.org/reports/consumer/payday/showmethemoneyfinal.pdf, (last visited Aug. 24. 2002) [hereinafter SHOW ME THE MONEY!]. The remaining states were not surveyed due to an insufficient number of volunteers. See id. at 1 n.2. Shortening the loan term will raise the APR. Drysdale & Keest, supra note 16, at 602-03 (discussing Indiana regulators who found a 7300% APR as a result of a $20 fee on a one-day $100 loan). It should be noted that payday lenders frequently shorten or sharply limit the term of their loans to increase the likelihood the borrower will have to pay a rollover fee, thus skyrocketing both profits and the annual percentage rate. See id. at 603.

132. Fox & Mierzwinski, supra note 63, at 3, 11.

133. Id. Ohio's payday loan rate, according to the CFA's Rent-A-Bank Payday Lending Report, is 390% APR. Id. at 11, 28; see also infra App., tbl.2 (showing that all lenders charged the same fee).

134. Edelman, supra note 36, at 176 n.24 (listing twelve states, but several have enacted payday loan statutes since Edelman's article was published).

135. SHOW ME THE MONEY!, supra note 131, at 4.

136. Id. at 3. The survey covers 235 stores in twenty states and the District of Columbia. Id. at 2.

137. Id. at 3.

138. Id. at 26; see also infra note 139 (providing citations for jurisdictions in which payday lending is legal).
According to the CFA, these state laws...
stem from pro-industry bills. Consequently, it should not be surprising that some states that have legalized payday lending have no maximum fee limitations. Of the states that limit fees and loan amounts, fees for payday loans range from as low as $5.50 on a $50 loan to as high as $120 on a $1000 loan. On the high end are Montana and Wyoming, which cap allowable effective APRs at 650% and 780%, respectively. On the low end are Oklahoma and Texas, which limit allowable effective APRs to 240% and 309%, respectively.

Currently, laws in nineteen states, Puerto Rico, and the Virgin Islands either mandate small-loan interest caps or make payday loans technically illegal because such loans violate double-digit APR limits. The CFA’s 2001 survey found an
average APR of 606% in six states prohibiting payday loans through their usury limits. Until recently, Arkansas and North Carolina permitted payday loans, but such loans were made illegal by judicial opinion or legislative inaction.

The above laws and opinions are being ignored by payday lenders offering "services" that are really disguised payday loans or by lenders partnering with banks (i.e., through rent-a-bank partnerships) to take advantage of a loophole in federal banking law.

excess of $1000, or 21% on the unpaid balance, whichever is greater); ME. REV. STAT. ANN. tit. 9A, § 2-401(2)(A)-(B) (West Supp. 2001) (setting forth a consumer loan structure with a 30% finance charge on unpaid balances up to $700, a 21% finance charge on unpaid balances between $700 and $2000, and a 15% finance charge on unpaid balances in excess of $2000 or 18% per year on the unpaid balances, whichever is greater); MD. CODE ANN., COM. LAW II § 12-102 (2000) (permitting lenders to charge interest at 6% per year); MASS. REGS. CODE tit. 209, § 26.06(1)(a) (2002) (permitting lenders to charge interest at 23% per year plus a loan administration fee of $20 for loans not in excess of $3000); MICH. COMP. LAWS ANN. §§ 493.13(1), 445.1854(1) (West Supp. 2002) (providing that lenders may charge interest at a rate not to exceed 25% per year); N.J. STAT. ANN. § 2C:21 to :19(a)(2) (West Supp. 2001) (forbidding interest rates in excess of 30% for noncorporations); N.Y. PENAL LAW § 190.40 (McKinney 2002) (subjecting payday lenders to a 25% APR criminal usury cap); OKLA. STAT. ANN. tit. 14A, § 3-508B(a)-(d) (West Supp. 2002) (permitting lenders to charge 20% on loans up to $29.99, 10% plus $3.00 per month for loans of $29.99-$35, 10% plus $3.50 per month for loans of $35-$70, and 10% plus $4.00 for loans of $70-$101.97); 41 PA. CONS. STAT. ANN. § 201 (West 1999) (establishing the maximum lawful interest rate at 6% a year); R.I. GEN. LAWS § 19-14.2-8(1)-(3) (1998) (providing that lenders may charge 3% a month on loans up to $300, 2.5% a month on loans from $300-$800, and 2% a month on loans of $800-$5000); W. VA. CODE ANN. § 47-6-5(a) (Michie 1999) (allowing lenders to charge a rate of $6 per $100 for a year, and proportionately for a greater or lesser sum).

147. Fox & Mierzwinski, supra note 63, at 3. According to Fox, these loans were made by scofflaw lenders or rent-a-bank lenders (i.e., payday loan companies in partnership with national banks) that attract customers through direct mailing or ads in the yellow pages. Id. at 10.

148. The Arkansas legislature authorized payday lending. ARK. CODE ANN. § 23-52-104(c)(1)(B), (c)(2) (Michie 1987) (permitting lenders to charge a fee not to exceed 10% of the face amount of the personal check plus $10). The Arkansas Supreme Court held this legislation unconstitutional because the Arkansas Constitution requires lawmakers to "prohibit usury." Luebbers v. Money Store, Inc., 40 S.W.3d 746, 750 (Ark. 2001). North Carolina allowed its payday loan statute to expire. N.C. GEN. STAT. § 53-281(d) (2001) (establishing July 31, 2001 as the expiration date on a payday lending statute that permitted lenders to charge a fee not to exceed 15% of the face value of a check). North Carolina's legislature learned about the ills of payday lending from a broad-based coalition of consumer advocacy, senior citizen, and civil rights groups. Fox & Mierzwinski, supra note 63, at 9.

149. See discussion supra Part I.B.2.

150. See discussion infra Part III. Even though at the time of the CFA's
Payday lenders may circumvent state usury law by partnering with banks located in states that allow higher APR rate charges. One surmises, then, that where such partnerships exist, the bank resides in a state with more favorable (i.e., higher allowable) interest rate maximums than the state in which the payday lender is located. For instance, Advance America charges an APR of 390% in several states where it is operating without a partnership with a national bank, but in Virginia, where such a partnership exists, Advance America charges an APR of 442% (thus evading Virginia's usury limit of 36%).

The foregoing data establish that lenders charge triple-digit interest rates regardless of the state law governing the jurisdiction where the consumers are located. Because many payday lenders charge fees amounting to triple-digit-interest rates irrespective of state law, it appears that these lenders are violating state law and not complying with the industry's purported commitment to limit its fees to those allowed by state and federal law.

Rent-A-Bank Payday Lending Report Virginia restricted payday lending, VA. CODE ANN. § 6.1-272.1 (Michie 1999) (permitting lenders under the Consumer Finance Act to charge interest at a rate not to exceed 36% per year) (amended 2002), payday loans were being offered by lenders who had partnered with national banks. Keest, supra note 44, at 1118 n.19.

151. See infra Part III.B.2.

152. See Fox & Mierzwinski, supra note 63, at 11-12.

153. VA. CODE ANN. § 6.1-272.1 (Michie 2001) (prohibiting lenders from charging interest rates greater than 36% on loans up to $2500).

154. See also CMTY. FIN. SERVS. ASS'N OF AM., BEST PRACTICES FOR THE PAYDAY ADVANCE INDUSTRY, at http://www.cfsa.net/pressreleases/bestpractices.pdf (last visited Sept. 24, 2001) [hereinafter BEST PRACTICES]. For further discussion of the industry's self-identified best practices, see supra notes 228-48 and accompanying text. The Ohio Survey discovered a glaring failure to comply with state law limiting the maximum charge for dishonored checks; this failure establishes noncompliance with the industry's "best practice" prohibition of fees not authorized by state law. When asked what the charge would be for a bounced check, 91% of the lenders stated they would charge the customer an amount greater than $20. See infra App., tbl.2; see also SHOW ME THE MONEY!, supra note 131, at 6 (stating that over 70% of payday lenders in the survey averaged a charge of over $22 for bounced checks). One charged $22.25, two charged $22.40, nine charged $25, two charged $26, one charged $27, one charged $28, and four charged $30. See infra App., tbl.2. Under Ohio law, a lender may collect,

collection charges not exceeding an amount equal to twenty dollars plus any amount passed on from other financial institutions for each check . . . returned or dishonored for any reason, provided that the terms and conditions upon which check collection charges will be charged to the borrower are set forth in the written loan contract described in division (A)(4) of section 1315.39 of the Revised Code.

OHIO REV. CODE ANN. §1315.40(B) (Anderson 2002) (emphasis added). While
2. Ohio Survey Shows Lenders Fail to Provide Basic Information

A recent survey conducted by the author reveals that consumers learn about the triple-digit interest rates charged by payday lenders only after signing the payday loan contract. This phenomenon results because payday lenders hide basic information. In doing so, these lenders violate mandatory disclosure requirements. In the summer of 2001, the author conducted the Ohio Survey, in which she surveyed payday businesses located in Franklin County, Ohio. The survey revealed the following lender practices: refusing to provide customers with basic written information about the payday loan transaction, giving consumers false or misleading information about the cost of credit, failing to advertise the cost of credit using APRs, refusing to supply customers with written disclosures prior to contract consummation, claiming no credit check would be conducted but doing so anyway without obtaining consumer consent, including clauses in their loan documents that appear to be illegal or unconscionable.

91% of the lenders surveyed quoted a returned-check fee greater than $20, the majority of them had no contract provisions disclosing such fees. See infra App., tbl.2. As a result, if such fees were actually assessed, they were in excess of state law. Two lenders had loan applications that provided, "Any check returned carries a 10% or $30 surcharge, whichever is greater." See Ace Check Express Check Cashing Agreement (on file with author); Kentucky Check Exchange Disclosure Statement (on file with author). Clearly, this provision seeks to charge more than the $20 allowed by state law, but the contracts contained no provisions about NSF fees or statements regarding passage to the customer of fees charged by the lender's bank. Consequently, these charges were unlawful.

155. See supra notes 61-62 and accompanying text (discussing TILA's disclosure requirement).

156. See infra note 169 (describing the display of a weapon in the payday lender's store); infra notes 425-28 and accompanying text (discussing documents in which payday lenders claim the ability to collect damages not authorized by state law). Many of the clauses contained in the loan documents will not be discussed in depth. Noteworthy is the fact that the majority (twelve of twenty-two) of payday lenders' documents have clauses reflecting the borrower's promise that the borrower was not currently in bankruptcy and had no intention to file bankruptcy. See Collected Payday Loan Applications and Contracts from the Ohio Survey (on file with author). Moreover, in the event the borrower defaults on the payday loan, the majority (twelve of twenty-two) of payday lenders' documents have clauses giving the lender the right to electronically debit the borrower's bank account for unpaid amounts. Id. There is a split in authority as to whether these clauses violate the Electronic Funds Transfer Act (EFTA), which states that "[n]o person may . . . condition the extension of credit to a consumer on such consumer's repayment by means of preauthorized electronic fund transfers." 15 U.S.C. § 1693k(1)
representing that consumers have the right to rescind the contract at no cost, allowing consumers to roll over payday loans in violation of state law, representing to consumers that the lenders have the ability to collect treble damages from defaulting consumers, and intimidating consumers with the threat of physical violence and criminal prosecution. This section of the Article analyzes the numerous violations of state and federal law uncovered in the Ohio Survey that occurred at the contract formation level. Scant case law exists in the payday loan context to support the author’s analysis. The lenders’ activities, however, should be construed as violations based on a plain meaning statutory construction and based on the purpose of applicable law.

Outlining the author’s methodology in conducting the Ohio Survey before discussing the specific findings of the Ohio Survey and violations of applicable law will provide context. The Ohio Survey investigated payday lending stores located in Franklin County, Ohio, which at the time of the survey had twenty-two payday lenders with eighty-three stores. The majority (95%) of the stores are located in Columbus, the fifteenth largest city in the United States, and the remaining stores are located in suburbs surrounding Columbus. Because some of the results of the Ohio Survey accord with national

(2000). An “electronic funds transfer” is defined as “any transfer of funds, other than a transaction originated by check, draft, or similar paper instrument, which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account.” Id. § 1693(a)(6). Arguably, payday lenders do not violate the EFTA even though they have loan agreements that require “authorization of an electronic funds transfer as a condition of credit.” Mitchem v. Paycheck Advance Express, Inc., No. 99 C 1858, 2000 WL 419993, at *1 (N.D. Ill. Apr. 14, 2000) (holding that because payday loans are originated by check, they are not covered by EFTA). But see Mitchem v. GFG Loan Co., Nos. 99 C 1866, 99 C 3075, 99 C 3158, 99 C 3665, 99 C 3981, 2000 WL 294119, at *7 (N.D. Ill. Mar. 17, 2000) (denying a payday lender’s motion to dismiss an EFTA claim on the grounds that the payday loan transaction was originated by a note and not a check).

157. See infra App., tbls.1-4; see also Smith v. Check-N-Go, Inc., 200 F.3d 511, 516 (7th Cir. 1999) (indicating that a “circle around the due date . . . does not turn a model form into a violation of law” which says that the finance charge and APR must be more conspicuous than any other disclosure).


surveys and because the majority of the nation's largest payday lenders were represented in the Ohio Survey, the results of the Ohio Survey would likely be found in a survey conducted on a national level. The author, along with research assistants, posing as potential customers, contacted (by telephone and in person) one store location for each of the twenty-two payday lenders in Franklin County and made sure locations from each geographic region of the county were represented in the survey. The Ohio Survey tested the

160. See infra notes 162-68 and accompanying text (comparing the Ohio Survey with other surveys). Some payday lending practices are brought to light for the first time in this Article. See infra App., tbls.1-4.

161. Although the budget for the Ohio Survey was not large enough to fund a nationwide survey, the majority of the nation's largest payday lenders have stores in Franklin County, Ohio. The Ohio Survey included a payday outlet from each of the following companies: Advance America, likely the nation's largest payday lender, see Geller, supra note 2, at 1 (noting that Advance America is based in Spartanburg, South Carolina, and has 1300 stores), available at 2001 WL 2995203; Ace Cash Express, Inc., the second largest payday lender having 1178 stores in thirty-five states and the District of Columbia, see Ace Cash Express website, at http://www.acecashexpress.com (last visited Aug. 24, 2002) (indicating that the Texas-based company has “more than 1,221 stores consisting of 999 company-owned stores and 179 franchised stores in thirty-four states and the District of Columbia”); Check into Cash, a Tennessee-based company with over 600 stores operating in eighteen states, see Check into Cash website, at http://www.checkintocash.com/locations.htm (last visited Aug. 7, 2001) (indicating that Check into Cash's headquarters are in Cleveland, Tennessee); Check 'n Go, a chain of the Ohio-based payday lender CNG Financial Corp., which operates about 700 Check 'n Go stores nationwide, see David Wichner, Payday Loans Can Trap Unwary in Debt, ARIZ. DAILY STAR, Aug. 18, 2000, at A1, available at 2000 WL 10247029; National Cash Advance, a growing payday lender with over 500 locations nationwide, see National Cash Advance website, at http://www.nationalcashadvance.com/Values.htm (last visited Aug. 7, 2001); and First American Cash Advance, a payday lender operating 350 stores in ten states, see George Hohmann, Arrival of Money-Lending Business Has State Officials Wary, CHARLESTON GAZETTE & DAILY MAIL, July 25, 2001, at PIA (quoting the manager of a new First American Cash Advance branch in West Virginia, who stated, “We are a marketing agent for the First National Bank in Brookings, S.D.”), available at 2001 WL 6680437.

162. SHOW ME THE MONEY!, supra note 131, at 5-6. Surely, payday lenders in Ohio, a Midwestern state, cannot represent the worst. Yet the violations discovered in Ohio should alarm state lawmakers and put them on notice that the practices may be far worse in states known for higher incidents of unscrupulous activities.

163. In addition to the stores listed above, see supra note 161, the following stores were surveyed as part of the Ohio Survey: Ace Check Express, Cash Advance, Affordable Advance, Always Payday, Cashland, Cash to Go Advance Loan, Checkland, Check$mart, Columbus Checkcashers, Express Payroll
industry's compliance with state and federal laws and compliance with the industry's best practice list. Data were collected during the following lending stages: information gathering, contract consummation, and contract rescission. The Ohio Survey did not test for legal violations after a customer's default. The Appendix shows the results of the Ohio Survey and enumerates, among other things, which payday lenders refused to provide information and which failed to make required disclosures.

The reader may be surprised to discover that the surveyors could not obtain basic written information about payday loans from the majority of lenders studied. While creditors generally have no legal obligation to give potential customers brochures or applications, 73% of the payday lenders surveyed during the information-gathering stage did not have brochures about payday loans available for potential customers to peruse and 77% refused to allow the surveyor to have a copy of the application to take home and review. Many simply stated, "I'll tell you all you need to know." Of those who refused to

164. See BEST PRACTICES, supra note 154; infra App., tbls.1-4 (listing the categories tested).
165. Obviously, the author did not want the research assistants to risk ruining or damaging their credit histories by defaulting on payday loans.
166. See infra App., tbl.1.
167. The author cannot provide an accurate count of how many lenders made this statement. The explanation for the lack of an accurate account follows. During the information gathering stage, three student research assistants contacted each store location surveyed. Each surveyor used a written form supplied by the Consumer Federation of America because this stage of the Ohio Survey was part of the CFA's national survey. The author instructed the surveyors to obtain as many answers as possible to the survey questions over the telephone before visiting the store locations. This strategy was employed so that the payday loan clerks would not be suspicious of the surveyors' motives and refuse to talk to them. Sometimes the surveyors called the store more than once and disguised their voices in order to obtain answers. The surveyors were not wired with any audio or video recording equipment. To avoid appearing suspicious, the author instructed the surveyors to finish the survey forms after leaving the stores. Instead of a survey form, the surveyors usually had a blank piece of paper to write down some of the information provided to them by the store clerk. The idea was for them to act naturally, like a reasonably intelligent customer would. After the surveyors returned from visiting the store locations, the author debriefed the surveyors about their experiences and reviewed the completed survey forms with them. The completed survey forms contain a wealth of information. Many of the comments made by the store clerks to the surveyors and many of the
provide an application, a few became belligerent and made statements such as "it's against company policy" or "it's illegal for you to take the application out of the store." Even after contract consummation, only 18% of the payday lenders gave the customer a copy of his or her signed application. Obtaining a copy of the payday loan application is important because most of them contain contractual obligations that one may not remember unless one has a photographic memory. In summary, by refusing to provide basic written information to potential customers, the payday lender fits the profile of a predatory lender even though it has no legal obligation to provide such information. Telling a potential customer, "I'll

surveyors' observations are not reflected in the survey forms, but the author wrote down information provided orally by the surveyors during their debriefing and that information is mentioned where relevant in this Article.

168. See supra note 167. The author has personally visited at least five payday loan stores and knows how difficult it is to obtain an application. To obtain some of the applications, the author and the surveyors had to pretend to apply for a loan and then claim to have forgotten something needed to obtain the loan. The author and the surveyors then concealed the application as we departed the store.

169. Many of these payday loan stores have security guards on site to prevent someone from violating store policy. In one store, shockingly, two research assistants saw an AK47 gun lying in plain view behind the teller's window. Imagine a store clerk wielding a weapon to prevent a consumer from exiting the store with a copy of the application! In another store, the clerk became suspicious of one of two research assistants that were in the store. The clerk, a male, began to approach the research assistant, who happened to be female, to physically remove her from the store. The other research assistant, a male, stopped the clerk from accosting the female.

170. See infra App., tbl.3.

171. See EZ Cash Advance Payday Loan Application (on file with author). On the back of its application is a "HOLDING AGREEMENT," which contains several provisions including the following:

In the event the Customer does not honor this agreement, the check or checks will be turned over to a check collection agency, and/or legal action will be taken to recover the amount due under the bad check law which states you may have to pay the amount of the check(s) ... in addition to the following amounts:

1. Collection costs, including attorney fees which will be set by the court.

2. One hundred dollars or two times the face amount of the check, whichever is more by award of the court.

Id. at 2. This provision is not in the loan contract signed by the consumer. See id. The application instructs the customer to complete the application in pencil but write his signature in ink. Id. at 1-2.

172. If the reader has, in recent years, attempted to purchase items such as a car or home, the reader will recall that realtors, lenders, and automobile dealers provide at least some basic written information to buyers—sometimes, too much information to absorb. Comparing these businesses to payday
tell you *all you need to know,* more likely means, "I'll tell you *what I want you to know.*"

a. Lenders Violate TILA's Disclosure Rules

Lending practices that attempt to limit the consumer's knowledge about payday loans frustrate the purpose of TILA. Its purpose is to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit."[^173] The Ohio Survey demonstrates that the majority of payday lending practices frustrate the express purpose of TILA and fail to comply with the industry's own pledge to adhere to the requirements of TILA.[^174]

i. Lenders Fail to Disclose the Cost of Credit

TILA does not mandate that a creditor orally supply information regarding the cost of credit; however, if the creditor chooses to respond to a consumer's oral inquiry about the cost of credit, the creditor must give the consumer the APR.[^175] If lenders, the author finds very suspicious the payday lending practice of providing no or very little written information. Except for payday loan transactions, a plethora of unbiased information about common consumer transactions may be easily obtained from other sources. See, e.g., Millie Bingham, *Brochure Lists Ohio Consumer Law,* DAYTON DAILY NEWS, Apr. 9, 2001, at 2C, available at 2001 WL 3836416; C.R. Roberts, *Business Briefly: Better Business Bureau Offers Credit Advice to Students,* MORNING NEWS TRIB. (Tacoma), Oct. 3, 2001, at D1 (telling parents and students where to easily find brochures on "understanding credit, buying a first car and renting a first apartment"), available at 2001 WL 3997273.


[^174]: See infra App., tbls.1-4.

[^175]: 15 U.S.C. § 1665a; 12 C.F.R. § 226.26(b) (2002) ("In an oral response to a consumer's inquiry about the cost of closed-end credit, only the annual percentage rate shall be stated, except that a simple annual rate or periodic rate also may be stated if it is applied to an unpaid balance."); Regulation Z, Official Staff Interpretations, § 226.26 ("The restrictions of §226.26 apply only if the creditor chooses to respond orally to the consumer's request for credit cost information."). A consumer is likely to give more weight to a payday lender's oral disclosures, even when false or misleading, than to a written APR disclosure because the statements will be vivid in comparison to a written disclosure. See, e.g., Richard E. Nisbett et al., *Popular Induction: Information Is Not Necessarily Informative,* in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 101, 113-15 (Daniel Kahneman et al. eds., 1982); Richard E. Nisbett & Lee Ross, *Human Inference: Strategies and Shortcomings of Social Judgment* 62 (1980) ("Vividness is defined as the emotional interest of information, the concreteness and imaginability of information, and the sensory, spatial, and temporal proximity of information."); Eugene Borgida & Richard E. Nisbett, *The Differential Impact
the APR cannot be determined in advance, the creditor may state an APR for a sample transaction. As explained in Part I.B.1 of this Article, the Federal Reserve Board, on March 31, 2000, finalized commentary to TILA which makes it clear that payday loans equal credit transactions covered by TILA.

Therefore, payday lenders in the Ohio Survey should have adhered to TILA's disclosure requirements when they chose to respond to the consumer's oral request. Yet in the Ohio Survey conducted during the summer of 2001, members of the industry failed to comply with a number of TILA's requirements, including providing correct responses to oral inquiries.

When Ohio payday lenders were asked during the information-gathering stage to state the APR for a $100 loan, only 32% of the payday lenders surveyed disclosed the APR. Ohio law allows a maximum fee of $7.50 per every $50 borrowed. Therefore, the maximum finance charge for a $100 loan would be $15.00, which amounts to an APR of 391% for a two-week loan. Incredibly, 32% of the payday lenders surveyed denied that there was an APR associated with the loan while 18% claimed they did not know the APR. Roughly, 14% stated that the $15 finance charge was the APR,

of Abstract vs. Concrete Information on Decisions, 7 J. APPLIED SOC. PSYCHOL. 258, 264-67 (1977) (conducting a study that found that vivid, unreliable information in the form of face-to-face comments had more impact on a college student's course selection decision than much more statistically reliable information in the form of course evaluations); Chris Guthrie, Framing Frivolous Litigation: A Psychological Theory, 67 U. CHI. L. REV. 163, 202-03 (2000); Jeff Sovern, Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists Under One Roof, 1993 Wis. L. REV. 13, 25-44.

178. See infra App., tbls.2-3.
179. See infra App., tbl.2.
180. OHIO REV. CODE ANN. §§ 1315.39(B), 1315.40(A) (Anderson 2002) (indicating that lenders may charge interest at a rate of 5% per $50 in principal plus an origination fee of $5, thus totaling $7.50 per $50 lent).
181. See infra App., tbl.2. In the Ohio Survey, the customer's question regarding the APR came after the customer had already asked the lender what the fee was for the loan. Because the lenders had already chosen to orally disclose the cost of credit stated in terms of the finance charge, the lenders had an obligation to then orally provide the APR. See 12 C.F.R. § 226.26(b) (2002) (“In an oral response to a consumer's inquiry about the cost of closed-end credit, only the annual percentage rate shall be stated, except that a simple annual rate or periodic rate also may be stated if it is applied to an unpaid balance.”) (emphasis added)). Therefore, responding “I don't know” did not excuse the lenders from complying with Regulation Z.
and one of the twenty-two lenders answered evasively: "That doesn't count because you don't have the money for a whole year." The results of the Ohio Survey resemble those in the CFA's 2001 Rent-A-Bank Payday Lending Report, where only 21% of payday lenders in twenty-six states verbally disclosed an APR in response to a customer's inquiry. In the CFA's 2000 Show Me the Money report, only 37% of payday lenders quoted even nominally correct APRs when asked by customers over the telephone.

To comply with TILA, payday lenders could have easily found out the APR by simply putting the appropriate figures into their computer programs. Several facts support this conclusion. First, each payday lender in the Ohio Survey charged the maximum fee allowed by state law and lent money in specified increments. Therefore, the lenders had a finite, manageable number of possible transactions for which to determine the APR. Several other lenders issued loans in $50 increments only. Moreover, given that most lenders claim not to perform credit checks on the borrowers, the lenders would have no reason to adjust the preset APRs following the initial credit application. Finally, because most of the lenders posted fee schedules for loans of various denominations, the APRs could have easily been posted along with the finance charge fees. Payday lenders contend that having to disclose the APR is misleading, but TILA mandates

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182. See infra App., tbl.2.
183. Fox & Mierzwinski, supra note 63, at 13.
184. Show Me the Money!, supra note 131, at 6.
185. Surveyors observed clerks entering information contained in applications. The clerks did no calculations; the software calculated the APRs.
186. See infra App., tbl.2 (listing the fees charged by the lenders surveyed); see, e.g., Check $mart's Deferred Deposit, Early Deposit Clause and Disclosure Agreement (containing a table showing loan amounts in $50 increments) (on file with author).
187. In fact, two payday lenders in the survey required loan amounts to be in $100 increments so that they could use their preprinted forms to make required disclosures.
188. See EZ Cash Advance Payday Loan Application, at 2 (on file with author).
189. See supra note 36 and accompanying text.
190. See infra App., tbl.1.
191. See, e.g., Anita Weier, Bill Caps Payday Loan Interest, CAP. TIMES (Madison), Oct. 1, 2001, at A1 (quoting a payday lending executive as saying that disclosing the cost of credit as an APR is misleading because the loan
that lenders disclose the cost of credit using an APR so that consumers can do comparison shopping.\textsuperscript{192} A consumer who has a basic understanding of APRs and who has the option of obtaining a cash advance using a credit card will readily recognize that the APR for a payday loan is astronomically higher than the APR charged for a credit card’s cash advance.\textsuperscript{193} By giving evasive answers and denying the existence of or claiming lack of knowledge about the APR, the payday lenders in the Ohio Survey not only failed to comply with TILA, but frustrated its primary purpose of providing consumers with information relevant to making an informed decision.\textsuperscript{194}

ii. Lenders Fail to Provide the APR

In addition to violating the disclosure requirements for oral inquiries, the majority of the Ohio payday lenders violated TILA’s advertising requirements. As stated previously, in the businesses surveyed, most lenders (nineteen out of twenty-two) had some type of fee schedule (posted on either a sign on the wall or on a placard on the teller’s window);\textsuperscript{195} yet 84\% (sixteen out of nineteen) had fee schedules that failed to disclose the APR for each loan amount.\textsuperscript{196} TILA provides that if a creditor advertises the finance charge, the cost of credit must be stated “as an annual percentage rate, (using that term).”\textsuperscript{197}

\begin{flushleft}
\textsuperscript{192} See discussion supra notes 61-62 and accompanying text.
\textsuperscript{193} Michele Chandler, Payday Loan Services Thrive in Florida as Economy Slows, KNIGHT-RIDDER TRIB. BUS. NEWS, May 15, 2001, at *8 (comparing a 20\% APR on a credit card cash advance with a 390\% APR on a payday loan), available at 2001 WL 20966017.
\textsuperscript{195} See infra App., tbl.1. The following three lenders had fee schedules that contained the APR for each loan amount: Check Into Cash, Advance America Cash Advance Center, and National Cash Advance. See Collected Payday Loan Documents from the Ohio Survey (on file with author).
\textsuperscript{196} See infra App., tbl.1. Only three of the Ohio lenders posted APRs along with the fees. In the national survey, only 22\% posted APRs. Fox & Mierzwinski, supra note 63, at 13.
\textsuperscript{197} Section 226.24(b) of Regulation Z provides,

\textit{Advertisement of rate of finance charge.} If an advertisement states a rate of finance charge, it shall state the rate as an “annual percentage rate,” using that term. If the annual percentage rate may be increased after consummation, the advertisement shall state that fact. The advertisement shall not state any other rate, except that a simple annual rate or periodic rate that is applied to an unpaid balance may be stated in conjunction with, but not more
To prove a violation of this provision, the Federal Trade Commission (FTC) would have to show that the fee schedules are advertisements and that the fees are finance charges.\textsuperscript{198} TILA's Regulation Z defines an advertisement as "a commercial message in any medium that promotes, directly or indirectly, a credit transaction."\textsuperscript{199} According to the Federal Reserve Board's Official Staff Commentary, a message includes "visual, oral or in print media."\textsuperscript{200} A few payday loan outlets surveyed had placards that consisted of nothing more than the words "loan fees" followed by, "$50=$57.50, $100=$115, . . . $500=$575."\textsuperscript{201} Two lenders had signs that provided the origination fee and the interest on the principal (for example, $5.00 origination fee, $2.50 interest on $50).\textsuperscript{202} Some of the stores had signs or placards containing three columns exactly like or similar to the following:\textsuperscript{203}

<table>
<thead>
<tr>
<th>Amount You</th>
<th>Fee Total</th>
<th>Amount of Your Check</th>
</tr>
</thead>
<tbody>
<tr>
<td>Want Back</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$50</td>
<td>$7.50</td>
<td>$57.50</td>
</tr>
<tr>
<td>$100</td>
<td>$15.00</td>
<td>$115.00</td>
</tr>
<tr>
<td>$500</td>
<td>$75.00</td>
<td>$575.00</td>
</tr>
</tbody>
</table>

All of the aforementioned fee-schedule formats constitute advertisements because they are commercial messages—visual media—that promote directly or indirectly the payday loan, a

\textsuperscript{198} The Federal Trade Commission has enforcement authority in the event of a TILA violation by a creditor under its jurisdiction. 15 U.S.C. §§ 45(b), 1607(c). Unfortunately, a consumer does not have a private cause of action for violations of TILA's advertisement requirements for consumer credit. See Smeyres v. Gen. Motors Corp., 820 F.2d 782, 783 (6th Cir. 1987).
\textsuperscript{199} See 12 C.F.R. § 226.24(b) (2002); see also 15 U.S.C. § 1664 (2000). Section 226.24(c) states that if the advertisement sets forth certain terms, including the finance charge, the advertisement must also disclose the amount or percentage of the down payment, the terms of repayment, and the APR. 12 C.F.R. § 226.24(c).
\textsuperscript{200} See F.R.B., Official Staff Commentary on Regulation Z, Cmt. 2(a)(2)-1.
\textsuperscript{201} See supra note 195.
\textsuperscript{202} Photograph of First American Cash Advances's poster, Oct. 10, 2001 (on file with author).
\textsuperscript{203} Photograph of Check\$mart's poster, Oct. 10, 2001 (on file with author). Kentucky Check Exchange's three columns were, "CHECK TO CUSTOMER," "FEE," and "CHECK TO KY CHECK EXCHANGE." Photograph of Kentucky Check Exchange's fee table (on file with author); Kentucky Check Exchange website, at http://www.checkex.com/feeschedule _oh.html (displaying a fee schedule that is substantially similar to the one observed in the store).
credit transaction. TILA's advertising provision applies to the advertisement of a finance charge, which is "the cost of consumer credit as a dollar amount." A finance charge "includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." No matter which fee-schedule format a payday lender uses, the posted fees represent "finance charges" because they are the cost of the payday loans stated in dollar amounts. All but three of the payday lenders studied failed to post the APRs along with their finance charges, thus violating TILA. One obvious reason why most of the payday lenders did not post the APR is that they do not want the consumer to realize the true cost of the loan. Disclosing the cost of credit as $15.00 does not appear to be a costly deal in comparison to an APR of 391% for a $100 loan. Fear of losing business, however, is not an excuse for failing to comply with the advertising requirements of TILA.

iii. Lenders Refuse to Provide Disclosures Prior to Contracting

Besides making truthful advertisements, payday lenders have a duty to make TILA disclosures available in writing to the consumer prior to actual contract consummation. As

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204. See supra notes 63-73 and accompanying text (establishing that payday loans are credit transactions). The case against two of the stores using the three-column format is even stronger because of the explanatory paragraphs typed above the fee schedules. For example, Check$mart had the following paragraph:

Check$mart has revised the payroll advance program to benefit you, the valued customer. All payroll advances will only be done in $50.00 increments. The following chart has been designed to help you determine the correct check amount. Please ask your friendly Check$mart teller at what level you should write your check.

Photograph of Check$mart’s poster, Oct. 10, 2001 (on file with author).

205. See 12 C.F.R. § 226.4(a).

206. Id.

207. See infra App., tbl.2.

previously established, creditors must disclose to consumers the cost of credit as a dollar amount—the finance charge—and as an APR. The timing of these disclosures is critically important if the purposes of TILA are to be fulfilled. TILA's section 226.17(a) of Regulation Z provides that "[t]he creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep." Section 226.17(b) subsequently provides that "[t]he creditor shall make disclosures before the consummation of the transaction."

In Polk v. Crown Auto, Inc., the United States Court of Appeals for the Fourth Circuit agreed with the plaintiff-consumer that the defendant-car dealer violated the timing disclosure requirements of TILA when it did not give the disclosures in a form that the plaintiff could keep until a few minutes after he had signed a contract purchasing a truck. Prior to consummating the purchase transaction, the car dealer explained the credit terms to the consumer but did not disclose the terms in written form until after both parties had signed the contract and the consumer was given a copy of it. The defendant wanted the court to adopt an interpretation that the creditor had complied with TILA so long as it had, before consummation, made the disclosures in some form, including orally, and had later given the consumer a copy of the disclosures in writing. The court disagreed based on a plain meaning and legislative intent interpretation:

[O]n balance, we believe that the plain meaning of the regulation must be understood to be that written disclosure in the form specified in subpart (a) must be provided to the consumer at the time specified in subpart (b). That is, Crown Auto was required to make the disclosures to Polk in writing, in a form that he could keep, before consummation of the transaction.

Not only are we satisfied that this is the plain meaning of the provision, but this interpretation comports with Congress' intent to require "meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms

transaction was consummated once the buyer signed the contract).

209. 15 U.S.C. § 1638(a)(3)-(4) (2000); see also supra notes 64, 173, 175, 197 and accompanying text.
210. 12 C.F.R. § 226.17(a) (emphasis added).
211. Id. § 226.17(b) (emphasis added).
212. 221 F.3d 691, 692 (4th Cir. 2000).
213. Id. at 691.
214. Id. at 692.
available to him."\(^{215}\)

The *Polk* decision has been hotly debated. Some believe it was incorrectly decided.\(^{216}\) Despite protest, the Federal Reserve Board has declined to modify or overrule section 226.17 of Regulation Z.\(^{217}\) Moreover, *Polk* has been followed by several courts.\(^{218}\)

The Ohio Survey reveals an industry-wide practice of refusing to provide consumers with a written copy of the required disclosures prior to contract consummation. Admittedly, every payday lender disclosed the APR in the written contract.\(^{219}\) But when the research assistants asked the loan clerks to allow them to take the contracts and review them prior to signing, 77% (seventeen of twenty-two) of the payday loan clerks surveyed would not allow the consumer to take the contract.\(^{220}\) Some clerks even held onto the corner of the written contract while the research assistants were reviewing it prior to signing. Such an act would be insufficient for TILA purposes because "courts that have considered the

\(^{215}\) Id. (quoting 15 U.S.C. § 1601(a)).

\(^{216}\) Thomas D. Domonoske, *New Issues in Consumer Credit Litigation: Truth in Lending Act Disclosures and Polk v. Crown Auto, and the Problem of a Conditional Credit Sale of a Car*, in *CONSUMER FINANCIAL SERVICES LITIGATION* 2001, at 497, 503 (PLI Corporate Law & Practice Course, Handbook Series No. B-1241, 2001) (stating that attorneys unhappy with the decision have asked the Federal Reserve Board to qualify or overrule the relevant regulation); Elizabeth C. Yen et al., *Truth in Lending in the Year 2000*, 56 *BUS. LAW.* 1089, 1108 (2001) (discussing how the "ramifications of the *Polk* decision are troublesome").

\(^{217}\) Domonoske, * supra* note 216, at 503.


\(^{219}\) See * infra* App., tbl.3.

\(^{220}\) See * infra* App., tbl.3.
issue have uniformly concluded that merely showing the consumer the disclosures in a contract before he or she signs the contract is insufficient; the consumer must be given a copy of the disclosures before signing the contract.\footnote{221} Additionally, TILA does not require the consumer to request the written disclosures before execution; the creditor bears the burden of providing the disclosures prior to contract consummation.\footnote{222} TILA "reflects a transition in congressional policy from a philosophy of 'Let the buyer beware' to one of 'Let the seller disclose.'"\footnote{223} Consequently, the Ohio payday lenders' practice of contemporaneously providing written disclosures at the time of contract consummation violates TILA.\footnote{224}

iv. Lenders Violate Their Own "Best Practice" of Complying with TILA

The Ohio Survey uncovered three TILA violations: failure to provide the APR in response to oral inquiries about the cost of the loan,\footnote{225} failure to provide the APR in payday loan advertisements,\footnote{226} and failure to provide the consumer with written disclosures prior to contract consummation.\footnote{227} Despite the lack of an economic incentive for TILA compliance, payday lenders purport a commitment to complying with the law and affording consumers some level of protection. In a strategic move to combat further regulation, the Community Financial Services Association of America (CFSA), the newly-formed trade association for the industry,\footnote{228} announced in 2000 a list of ten best practices that its members should follow.\footnote{229}

\footnotesize

\footnote{221. } Spearman, 2001 WL 987849, at *4.  
\footnote{222. } Id. at *5 ("It would be contrary to the purpose of TILA to impose a duty on the consumer to obtain the required disclosures.").  
\footnote{224. } See Spearman, 2001 WL 987849 at *5 ("Contemporaneous disclosure . . . does not comply with Regulation Z's requirement that the disclosure be before consummation of the transaction.").  
\footnote{225. } See supra Part II.A.2.a.i.  
\footnote{226. } See supra Part II.A.2.a.ii.  
\footnote{227. } See supra Part II.A.2.a.iii.  
\footnote{228. } CFSA website, at http://www.cfsa.net/pressreleases/bestpractices-pr.html (last visited Sept. 1, 2002) (indicating that CFSA was formed in 1999).  
\footnote{229. } See Rehm, supra note 14, at 4; see also Steve Jordon, Payday-Loan Trade Group Develops Industry Practice Standards, KNIGHT-RIDDER TRIB. BUS. NEWS (Omaha), Apr. 12, 2000, at *8 (indicating that there are forty-eight
thereafter, the list was amended and an eleventh best practice was added to "reflect CFSA's responsiveness to the emerging concerns of policy makers as well as our commitment to providing substantive consumer protections and ensuring the long-term success of the industry."230

Specifically, the CFSA professes a commitment to "comply with the disclosure requirements of the State in which the payday advance office is located and with Federal disclosure requirements including the Federal Truth in Lending Act."231 When asked to state the APR for a $100 loan in the Ohio Survey, however, 68% of the payday lenders violated TILA by failing to disclose the APR.232 Yet, a consumer in desperate need of a payday loan is not likely to ask for the APR of the loan. Moreover, a consumer who later complains about the lack of disclosure will have great difficulty proving at trial the content of any oral recitation by the lender of a different APR.233 Consequently, payday lenders lack any incentive to comply with TILA's requirement for a response to oral APR inquiries or to comply with the best practice of full disclosure.

In addition to lacking an incentive to comply with TILA's disclosure requirements for oral inquiries, a majority of payday lenders have no incentive to comply with TILA's advertising requirements. When it first announced its best practices list, the industry pledged to comply with TILA as a guide for truthful advertising.234 Only 16% (three out of nineteen) of the lenders surveyed, however, posted fee schedules stating the

CFSA members with a total of CFSA 6000 payday loan stores nationwide), available at 2000 WL 19315696. For the complete list of the CFSA's best practices, see BEST PRACTICES, supra note 154.

230. BEST PRACTICES, supra note 154.
231. Id.
232. See supra note 179 and accompanying text.
233. Proving a violation will be easy if the conversation was recorded and video-taped. See Sovern, supra note 175, at 78 n.259 ("[S]ignificant enforcement problems exist with oral disclosures. Unless some means is found for spot-checking conversations, efforts to enforce invariably come down to credibility judgments about whether fact-finders believe the consumer, who claims no disclosure was provided, or the seller, who claims it was.").
234. Jordan, supra note 229 (indicating that CFSA members pledge that "[a]dvertising will not be false, misleading or deceptive, using the federal Truth In Lending Act" as a guide). Brochures obtained in the Ohio Survey also confirm this fact. See Collected Payday Loan Documents from the Ohio Survey (on file with author). Notably, the industry's website currently makes no reference to TILA. BEST PRACTICES, supra note 154. Removal of this reference to TILA, however, does not remove payday loan transactions from TILA's coverage. See discussion supra Part I.B.1.
APR for each loan amount. The most obvious reason for this noncompliance is that the lenders do not want the consumer to realize the amount of the finance charges. Continued noncompliance with TILA's advertising requirements remains likely because payday lenders fear losing business if their advertisements disclose the APR. Further, no private right of action exists for a creditor's violation of TILA's advertising requirements and the FTC does not have the resources to pursue the numerous violators. Thus, no economic incentives exist to spur payday lenders to advertise truthfully.

As with TILA's advertising requirements, current laws fail to motivate payday lenders to comply with TILA's timing-of-disclosure requirements. As discussed earlier, a majority (77%) of the Ohio lenders surveyed refused to provide the customer with a copy of the contract containing TILA disclosures prior to contract-consummation. This widespread practice is consistent with a larger industry pattern of keeping the consumers uninformed about the true cost of payday loans. Consequently, consumers cannot obtain full disclosure about

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236. As Professor Whaley observes, "[T]he amount of credit advertising is large and the resources of the FTC are meager; the upshot is that you can open the morning newspaper, glance at billboards, and turn or the radio or TV and hear violation after violation of the advertising rules." WHALEY, supra note 62, at 488; see also Johnson v. TeleCash, Inc., 82 F. Supp. 2d 264, 266 (D. Del. 1999) (discussing the importance of not enforcing arbitration clauses in order to encourage class actions under TILA "because of the apparent inadequacy of the Federal Trade Commission's enforcement resources and because of a continuing problem of minimum compliance with [TILA] on the part of creditors"), rev'd sub nom., Johnson v. W. Suburban Bank, 225 F.3d 366, 371-78 (3d Cir. 2000), cert. denied sub nom., Johnson v. Tele-Cash, Inc., 531 U.S. 1145 (2001).

237. See supra notes 219-20 and accompanying text.

238. See discussion supra Part II.A.2.a (explaining that the Ohio Survey discovered that a majority of payday lenders do not make written pamphlets available about payday loans, and that the majority violate TILA by failing to disclose the APR at both the information-gathering and contract-consummation stages). Several days, and sometimes weeks, transpired between information-gathering and contract-consummation.
the cost of credit until the contract is consummated. Consumers brave enough to sue lenders for TILA violations face difficulty obtaining lawyers and receiving a compensatory award because of a growing trend among payday lenders of including contract provisions mandating that all claims against the lenders be arbitrated and, in some instances, preventing the consumer from filing class action suits. Nine of the twenty-two payday lender contracts obtained in the Ohio Survey contained arbitration clauses. Of those nine

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239. See, e.g., Johnson v. W. Suburban Bank, 225 F.3d at 366 (upholding an arbitration clause in payday loan contract); Gretchen Schuldt, Payday Loan Suit Certifies Class Action, MILWAUKEE J. & SENTINEL, Dec. 14, 2000, at B3 (indicating that McKenzie Check Advance of Wisconsin began including arbitration clauses in its loan agreements after a lawsuit was filed against it in 1998), available at 2000 WL 26101516. If these clauses are upheld, consumers will be deprived of the ability to bring class actions. Johnson v. W. Suburban Bank, 225 F.3d at 371-78 (reversing a district court’s refusal to enforce arbitration clause in payday loan contract); Alan S. Kaplinsky, Arbitration and Class Actions—A Contradiction in Terms, SF81 ALI-ABA 173, 186 (2001) (“[T]he inability of a plaintiff to pursue relief on behalf of a class in a case challenging the legality of a relatively modest payday loan agreement is likely to have a significant practical effect on the ability of a consumer to obtain relief authorized by federal statutes . . . .”), available at WL SF81 ALI-ABA 173. Class actions are the only real way for consumers to enforce their TILA rights and to deter violaters:

[T]here is not much incentive in the Act for individuals to pursue alleged Truth-in-Lending violations. The costs of litigation against a financial institution can be enormous, actual damages are difficult to prove and the statutory recovery is low. It is in most individuals’ interests, however, and in the public interest that lending institutions comply with the Act and be found responsible to consumer borrowers if they do not comply. Were it not for the class action, many borrowers likely would not pursue their rights in court.

Hughes v. Cardinal Fed. Sav. & Loan Ass’n, 97 F.R.D. 653, 655-56 (S.D. Ohio 1983) (emphasis added); see also Goldman v. First Nat’l Bank, 532 F.2d 10, 15 (7th Cir. 1976) (recognizing the importance of class actions under TILA “to prevent violators of the Act from limiting recovery to a few individuals where actual, wide-spread [sic] noncompliance is found to exist”) (quoting Haynes v. Logan Furniture Mart, Inc., 503 F.2d 1161, 1164 (7th Cir. 1974)). Fortunately for consumers, some courts have refused to enforce arbitration clauses in payday loan contracts. See, e.g., Showmethemoney Check Cashers, Inc. v. Williams, 27 S.W.3d 361, 366-67 (Ark. 2000) (holding that an arbitration clause lacks mutuality because only the consumer had an obligation to arbitrate all claims against lender); Hayes v. County Bank, 713 N.Y.S.2d 267, 270 (N.Y. Sup. Ct. 2000) (denying enforcement of an arbitration clause because it would prevent class action relief, relying in part on the district court’s decision in Johnson v. Tele-Cash that was subsequently reversed).

240. The Ohio Survey found arbitration clauses in contracts from Advance America, Check Into Cash, Check ‘n Go, Check$mart, Express Payroll
contracts, five included clauses waiving the consumer's ability to file class actions, three included clauses shifting the arbitration fees to the consumer in the event the lender prevails, three contained clauses allowing the arbitrator to decide who should bear the costs of arbitration, and four granted the arbitrator authority to award attorney's fees to the prevailing party. Given the payday lenders' pattern of noncompliance with several TILA requirements and their inclusion of the arbitration clauses, payday lenders lack an economic incentive to adhere to TILA's timing-of-disclosure requirements.

b. Lender Deception: The Customer's Purported Right to Rescind at No Cost

The Ohio payday lenders add to their predatory image by falsely representing that consumers have the option to rescind payday loans. CFSA members claim that they will follow the best practice of allowing a customer to rescind a payday loan at no cost if rescission is sought by the close of the business day following the initial transaction. Many payday lenders display posters at their outlets that indicate they are members of the CFSA and list all of the best practices, including the practice of permitting cost-free rescissions. The Ohio Survey tested compliance with this best practice and discovered only 50% of the CFSA members authorized a cost-free rescission when the customer requested one.

Advance, National Cash Advance, Columbus Check Cashers, First American Cash Advance, and Kentucky Check Exchange, Inc. See Collected Payday Loan Documents from the Ohio Survey (on file with author).

241. The following payday lenders had boilerplate language precluding borrowers from serving as representatives or members of a class of claimants in any suits filed against the lenders: Advance America, Check Into Cash, National Cash Advance, First American Cash Advance, and Kentucky Check Exchange, Inc.

242. State efforts to protect consumers from odious arbitration clauses have been struck down under the Supremacy Clause as violating the Federal Arbitration Act. See Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (holding that the purpose of the Federal Arbitration Act was to ensure that arbitration agreements were placed on grounds similar to enforceable contracts and that a Montana state law requiring arbitration clauses to give special notice violated the act because the special notice provision did not apply to contracts generally).

243. BEST PRACTICES, supra note 154, at 1.

244. See infra App., tbls.3-4.

245. See infra App., tbls.3-4. Fourteen out of the twenty-two (64%) lenders surveyed are members of CFSA. See infra App., tbl.4. ACE was the only non-
Falsely representing that consumers can make cost-free rescissions constitutes a deceptive act in violation of federal and state laws aimed at preventing deceptive acts. Section 5 of the Federal Trade Commission Act (FTC Act) authorizes the FTC to regulate conduct which prohibits "unfair or deceptive acts or practices in or affecting commerce."246 Under the FTC Act, "commerce" means a company's course of business,247 and therefore would include payday loan businesses.248

The FTC possesses "considerable latitude" in determining what constitutes an unfair or deceptive act.249 The FTC's 1983 Policy Statement on Deception defines a deceptive practice as "a representation, omission or practice that is likely to mislead the consumer acting reasonably in the circumstances, to the consumer's detriment."250 Representing that cost-free

CFSA member that allowed the customer to make a cost-free rescission. See infra App., tbls.3-4.

247. See id. § 44.
248. Certain entities, such as banks, savings and loan associations, and credit institutions, are exempt from the FTC's jurisdiction. See id. §§ 45(a)(2), 46(b). Payday lenders, however, do not meet the definitions of the lending institutions exempted from the FTC's jurisdiction. See id. §§ 57a(f)(1), (3) (indicating that the Federal Reserve Board has jurisdiction over unfair and deceptive acts committed by banks, savings and loan associations, and credit institutions). "The exclusion of banks from the FTC's jurisdiction appears to have been motivated by the fact that banks were already subject to extensive federal administrative controls." United States v. Phila. Nat'l Bank, 374 U.S. 321, 336 n.11 (1963) (construing T.C. Hurst & Son v. Fed. Trade Comm'n, 268 F. 874, 877 (E.D. Va. 1920)). Consequently, the FTC has jurisdiction over payday lenders. For a discussion of an FTC lawsuit against payday lenders, see infra notes 251-55 and accompanying text.
249. Fed. Trade Comm'n v. Colgate-Palmolive Co., 380 U.S. 374, 385 (1965) ("The Commission's judgment is to be given great weight by reviewing courts."); Jeff Sovern, Protecting Privacy with Deceptive Trade Practices Legislation, 69 FORDHAM L. REV. 1305, 1320-21 (2001) (discussing several reasons why "the FTC has considerable latitude in determining whether particular conduct violates the FTC Act"); Candace Lance Oxendale, Comment, The FTC and Deceptive Trade Practices: A Reasonable Standard?, 35 EMORY L.J. 683, 685 (1986) ("[T]he appellate courts, mindful of the presumed expertise of the Commissioners in the field of trade regulation, have applied a very deferential standard of review to FTC determinations."). The Supreme Court has afforded the FTC considerable latitude in fashioning appropriate remedies because of its expertise and has held that FTC's determinations will not be disturbed unless "the remedy selected has no reasonable relation to the unlawful practices found to exist." Jacob Siegel Co. v. Fed. Trade Comm'n, 327 U.S. 608, 612-13 (1946).
rescissions can be made likely misleads reasonable consumers to their detriment because they might erroneously believe they can back out of a payday loan if they later decide it was not the right solution for dealing with their financial crisis and because the consumers who are not permitted to rescind will be unable to recover the fee.

In the FTC's first action against payday lenders, Consumer Money Markets, Inc., Continental Direct Services, Inc., and several other connected entities falsely represented that consumers would receive a credit line, including cash advance privileges, of thousands of dollars if they paid a membership fee ranging from $149 to $169. After paying the fees, consumers discovered that they could only use the credit line to buy items from Consumer Money's catalog or to obtain payday loans at interest rates of up to 360%. The FTC alleged that this scheme amounted to deceptive acts or practices in violation of section 5(a) of the FTC Act. Although this case settled, the allegations suggest that, like Consumer Money, half of the payday lenders in the Ohio Survey engage in deceptive acts by falsely representing that they allow consumers to make cost-free rescissions of payday loans.

Cliffdale Assocs., 103 F.T.C. at 164-65. A misleading representation includes a "failure to perform promised services." Id. at 175.


253. Id.


255. Arguably, the Consumer Money case is distinguishable because the deception there went to the heart of the transaction. An act can be deceptive even when tangentially related to the main transaction. Recently, the FTC has aggressively used its authority to bring charges of unfair and deceptive trade practices against companies who fail to comply with the terms of their own Internet privacy policies. See, e.g., First Am. Compl., FTC v. ToySmart.com (D. Mass. 2000) (No. 00-11341-RGS) (alleging that the company disclosed, sold, or offered for sale personal customer information despite a privacy policy representing the confidentiality of information supplied),
Payday lenders might maintain that a mere failure to perform a contractual promise gives rise only to a breach-of-contract claim, not a deceptive act claim under state or federal law. If the actor had no intention of performing when the promise was made, however, that failure to perform is a deceptive act, and intent not to perform may be inferred from the circumstances, including the actor's subsequent conduct. In *Mapp v. Toyota World*, the plaintiff alleged that the defendant committed an unfair and deceptive act under Georgia law when the defendant led her to believe that she could rescind an agreement to purchase an automobile. In ruling on the sufficiency of the evidence supporting a jury verdict in favor of the plaintiff, the court stated that "the jury could reasonably find that defendant induced plaintiff to purchase the Ford Escort by promising her that she could...

http://www.ftc.gov/os/2000/07/ (July 21, 2002). Toysmart's website stated that "[p]ersonal information voluntarily submitted by visitors . . . is never shared with a third party." (showing Toysmart's privacy policy). However, after announcing it would cease operations, Toysmart attempted to sell this information. First Am. Compl., Toysmart.com, (No. 00-11341-RGS). The customer list included information obtained from children who entered a contest at Toymart's website by supplying their names, ages, and e-mail addresses. *Id.* The FTC alleged that Toymart committed a deceptive act by representing that customer information would never be sold but later soliciting bids for its assets, including its customer information. *Id.* If a company's false representation regarding the confidentiality of consumer information is a deceptive act, certainly a payday lender's false representation regarding the ability of customers to rescind payday loans is a deceptive act. The latter deception results in a pecuniary loss to the customer. Toymart later consented to a FTC order that prohibited the sale of Toymart's personal customer information except to a family-oriented website that was willing to purchase the entire Toymart business and agree to the terms of the order. Stipulated Consent Agreement, Ex. 1, Toymart.com (No. 00-11-11341-RGS), http://www.ftc.gov/os/2000/07. The fate of the list was finally determined when the bankruptcy judge approved Walt Disney Co.'s $50,000 offer to purchase and destroy it. Greg Sandoval, *Judge OK's Destruction of Toymart List*, CNET NEWS.COM, Jan 31, 2001, at http://news.com.com/2100-1017-251893.html (last visited Oct. 18, 2002).

256. At common law, "[a] promise to do something in the future is actionable fraud 'only when made with the intention, design and purpose of deceiving, and with no intention of performing the act' at the time the promise was made." Perez v. Alcoa Fujikura, Ltd., 969 F. Supp. 991, 1009 (W.D. Tex. 1997) (quoting Spoljaric v. Percival Tours, Inc., 708 S.W.2d 432, 434 (Tex. 1986)).

257. *See Mapp v. Toyota World*, Inc., 344 S.E.2d 297, 300 (N.C. Ct. App. 1986) (explaining that if a promisor has no intention of fulfilling a promise when it was made, such behavior is evidence of fraud, and that proof of fraud constitutes a violation of the statute prohibiting deceptive acts).


259. *Toyota World*, 344 S.E.2d at 299.
return the car if she was not satisfied with it and that defendant had no intention of allowing plaintiff to return the car when this promise was made.260 The court found that the plaintiff showed more than a breach of promise but “a fraudulent scheme, i.e., a contract induced by the defendant's promise to allow rescission of the contract by plaintiff, which promise defendant never intended to keep.”261

Similarly, the court in Orkin Exterminating Co. v. FTC, held that a creditor's practice of breaching form contracts constitutes an unfair trade practice under the FTC Act.262 In that case, Orkin, an exterminator, entered into “lifetime” contracts with over 200,000 customers to provide them extermination services at annual fixed rates.263 Over the years, however, Orkin decided that these fixed-rate contracts jeopardized its profitability and unilaterally raised the rates.264 In upholding the FTC's decision that Orkin committed an unfair trade practice, the court rejected Orkin's argument that Orkin merely breached a contract provision and held that Orkin's practice represented a breach of over 200,000 contracts.265 The court found that whether or not Orkin intended to deceive its customers was irrelevant because a practice in violation of the FTC Act “may be unfair without being deceptive.”266

Like Orkin, many of the lenders in the Ohio Survey represent that consumers have the right to rescind the payday loan deal but refuse to allow them to do so.267 This is an unfair practice in violation of the FTC Act, and a deceptive practice if, in reality, payday lenders have no intention of allowing rescissions. Therefore, such a representation should constitute an unfair or deceptive act under federal and state law.

Currently, payday lenders have no incentive to refrain from falsely representing the ability of customers to rescind. Until the Ohio Survey, no one knew about the large percentage

260. Id.
261. Id. at 301 (emphasis omitted).
262. 849 F.2d 1354, 1367-68 (11th Cir. 1988).
263. Id. at 1355-56.
264. See id. at 1357-58.
265. Id. at 1366-68.
266. Id. at 1367.
267. See infra App., tbl.4.
of noncompliance with the best practice of allowing cost-free rescissions.\textsuperscript{268} Moreover, except for Colorado and North Dakota, no state or federal law requires payday lenders to permit cost-free rescissions.\textsuperscript{269} Consequently, except in those states, payday lenders are not breaking any express law when denying rescissions. While CFSA members are ostensibly committed to following the best practice of permitting cost-free rescissions, no economic incentive exists for payday lenders to follow this practice because permitting rescissions limits the payday lenders’ ability to generate significant revenue from consumers who get caught in the cycle of indebtedness.

Given that half of the CFSA members in the Ohio Survey did not allow cost-free rescissions and given that they failed to comply with other laws previously discussed,\textsuperscript{270} the industry’s best practice commitment may just be a smoke screen designed to convince legislators that the industry does not need additional regulation. Like the Ohio Survey, other surveys of the industry show that payday lenders do not disclose the cost of credit.\textsuperscript{271} Accordingly, the refusal to make required

\textsuperscript{268} Although several articles exist on payday lending, they do not discuss payday lenders’ noncompliance with the best practice of allowing cost-free rescissions. See, e.g., Drysdale & Keest, supra note 16; Miller, supra note 20; Scott Andrew Schaaf, Note, From Checks to Cash: The Regulation of the Payday Lending Industry, 5 N.C. BANKING INST. 339 (2001).

\textsuperscript{269} See COLO. REV. STAT. § 5-3.1-106(2) (2001) (“A consumer shall have the right to rescind the deferred deposit loan on or before 5 p.m. the next business day following the loan transaction.”); N.D. CENT. CODE § 13-08-12(6) (Supp. 2000) (stating that “the maker may rescind the transaction by the close of the following business day at no cost”). Colorado law also requires the following notice to be included in the contract: “YOU HAVE THE RIGHT TO RESCIND THIS TRANSACTION BY 5 P.M. THE NEXT BUSINESS DAY FOLLOWING THIS TRANSACTION.” COLO. REV. STAT. § 5-3.1-107.

\textsuperscript{270} See supra Parts II.A.1, II.A.2.a.

\textsuperscript{271} See, e.g., Fox & Mierzwinski, supra note 63, at 1 (revealing in a 2001 survey that only 21% of payday lenders orally disclosed the APR in response to customer’s inquiry); SHOW ME THE MONEY!, supra note 131, at 6 (revealing that in a 2000 survey only 37% (85 of 230) of lenders quoted nominally correct APRs when asked by customers over the telephone). A 2001 Colorado study found that 70% of payday lenders in Colorado do not disclose the cost of these loans on applications or information materials although nondisclosure may not be illegal. EMILY HOOPE, COLO. PUB. INTEREST RESEARCH GROUP, SMALL LOANS—BIG $MONEY$: A SURVEY OF PAYDAY LENDERS IN COLORADO AND REVIEW OF THE COLORADO DEFERRED DEPOSIT LOAN ACT OF 2000, at 8, at http://www.copirg.org/consumer/payday/report4_18_01.pdf (Apr. 2001). The Colorado study also found that 94% of the lenders surveyed failed to conspicuously post fees in accordance with state law. Id. at 8.
disclosures reflects a nationwide practice. While payday loan customers may be able to effectively challenge these pre-contract payday lending practices under a plethora of state and federal consumer protection laws, many states' laws fail to adequately protect consumers from post-consummation practices that can be characterized as nothing less than unconscionable.

B. EGREGIOUS PRACTICES POST-CONSUMMATION

This section differs from the previous one in that it analyzes payday lending practices occurring post-consummation. These practices may result in the greatest harm to the consumer. At contract formation, a predatory payday lender takes the first bite at the customer's wallet. After contract consummation, however, the lender may devour the customer’s money through the use of rollovers (the collection of fees to extend the loan’s due date), and through the use of unfair collection practices (including the collection of treble damages).

1. The Debt Treadmill: Rollovers

Recognizing that some consumers become payday loan customers even though they should not, members of the CFSA purport to adopt the best practices of limiting rollovers and encouraging consumer responsibility so that consumers will use payday loans only as a solution to a short-term financial crisis. In states that expressly prohibit rollovers, industry members purport to disallow rollovers; in the remaining states, members purport to limit rollovers to the lesser of four or the state law limitation. A casual observer may think the payday loan industry should be commended for recognizing that payday loans are not right for consumers in the throes of long-term debt problems. But consider again the case of Leticia Ortega who obtained a $300 loan from National Money

272. BEST PRACTICES, supra note 154. To achieve these best practices, members are supposed to implement policies and procedures that inform consumers that payday loans are intended to serve as a short-term cash flow solution, not as a tool for managing long-term financial problems.

273. Id. In states that prohibit rollovers, members are not allowed to use them. Id. In states that permit them, members are not to allow customers to roll over a payday loan more than four times. Id.
Assuming National Money Service is a CFSA member, it should have informed Ms. Ortega that the payday loan should only be used to cover a short-term financial crisis and should have limited her to only four rollovers. Rather than taking $90 from her bank account every two weeks for almost a year, National Money Service should have extracted from Ms. Ortega $450 (the initial $90 loan fee plus $360 in rollover fees), not $1800.

This section scrutinizes the rollover practice and demonstrates how payday lenders earn generous revenues even when being “kind” enough to limit rollovers. It also explains why payday lenders have no real incentive to foster consumer responsibility or limit rollovers in the absence of state law. First, state laws currently fail to address all the various forms rollovers may take. Second, repeat business constitutes a major component of the industry’s revenue. Consequently, states limiting or prohibiting rollovers should amend their statutes to encompass the various rollover manifestations and thereby hold the industry to its purported commitment of encouraging consumer responsibility and limiting rollovers.

a. Rollovers Defined

Many, if not most, payday loan customers lack sufficient funds to pay off the entire indebtedness by the loan’s due date and therefore have to roll over the loan. A “rollover” normally means a customer’s payment of a fee to extend the payday loan’s due date for another two weeks. Ms. Ortega’s experience represents a straightforward rollover. As explained later, rollovers should be defined more broadly to encompass not only the straightforward practice of paying a renewal fee

274. See supra notes 1-10 and accompanying text (giving an account of Leticia Ortega’s experience with National Money Service).

275. See Morning Edition: Payday Lenders and the Financial Strain They Place on Some Borrowers (National Public Radio broadcast, July 2, 2001) [hereinafter NPR Broadcast] (“Critics say the real danger is not to those who borrow every now and then, but those who borrow over and over.”), 2001 WL 9328000.

276. See discussion infra Parts II.B.1.b, III.A.

277. See, e.g., James P. Nehf, Consumer Transactions: Movement Toward a More Progressive Approach, 34 IND. L. REV. 599, 609 (2001) (“[Consumers] can roll over the loan by paying an additional ‘loan financing charge’, thereby earning additional time to repay an even larger amount of money.”).
but also the practice of refinancing a loan by taking out a “new loan” from the same payday lender to pay off the “old loan” with the proceeds from the new.\textsuperscript{278} An example of a refinancing loan is when a customer who took out a $115 loan two weeks ago gives the lender a new postdated check either for $130 (the original $115 loan plus a $15 fee) or for $100 (if the fee must be paid in cash).\textsuperscript{279} The definition of rollover should also include borrowing from Peter and paying off Paul,\textsuperscript{280} that is, taking out a new loan from a different/second lender to pay off an outstanding loan previously obtained from the first lender.

b. Many Customers Roll Over Payday Loans

No matter what form a rollover takes, the results are the same: The customer steps onto the payday loan debt treadmill by making a stream of interest-only payments without reducing the principal and without obtaining additional cash.\textsuperscript{281} Evidence of the debt treadmill may be found in studies conducted by state regulators and industry analysts. In a 1999 study, the Illinois Department of Financial Institutions found that the one-time payday loan customer represented the exception and found customers held an average of thirteen contracts.\textsuperscript{282} Illinois also found that the average payday loan customer remains a customer for at least six months and pays an average APR of 533\%.\textsuperscript{283}

Illinois’s findings about rollovers were similar to findings made by regulators and industry analysts in other states. In 1999, the Indiana Department of Financial Institutions reviewed 54,508 payday loans and found that 77\% of existing

\textsuperscript{278} This refinancing is also called “touch and go.” Drysdale & Keest, supra note 16, at 601 (“In a practice called ‘touch and go,’ lenders may take a cash ‘payoff’ for the old loan that they immediately reloan with new loan funds.”).

\textsuperscript{279} Miller, supra note 20, at 141.

\textsuperscript{280} Drysdale & Keest, supra note 16, at 601.

\textsuperscript{281} See id.

\textsuperscript{282} Id. at 608. The study reported, “The high expense of a short term loan depletes the customer’s ability to catch-up, therefore making the customer ‘captive’ to the lender.” ILL. DEPT. OF FIN. INSTS., SHORT-TERM LENDING: FINAL REPORT 30 (1999), http://www.state.il.us/dfi/ccd/Shorterm.pdf (last visited Sept. 20, 2002). While it is theoretically possible that this average of thirteen contracts represents separate loans rather than rollovers, it is highly unlikely when one compares this average with the data from other states.

\textsuperscript{283} Drysdale & Keest, supra note 16, at 602.
loans were rollovers with the average customer rolling over ten
times. The average loan amount was $165 and the average APR was 499%. In a 2000 survey, the Iowa Division of Banking found an average of 12.5 loans per year per customer, an average loan of $239.23, and an average APR of 342.10%. Forty-eight percent of the customers held at least twelve loans in the preceding twelve months, and 11.5% held more than twenty-five. The Colorado Public Research Interest Group found that the average APR on a loan in that state was 451.7%, and Colorado regulators reported that payday loans were refinanced “as many as thirteen or more” times. In 1999, the North Carolina Office of the Commissioner of Banks’ payday lending report indicated that 38.29% of customers studied transacted business with the same payday lender nine or more times and 14.06% did so nineteen or more times. Although criticized for underestimating the number of rollers, the Wisconsin Department of Financial Institutions analyzed 3678 loans and found in its 2001 survey that the average loan and APR were $246 and 542%, respectively, and that 63% of the loans were rolled over once or twice and 38% were rolled over “more than three times in a row.” One borrower in the

286. Keest, supra note 44, at 1114.
287. Id.
288. HOOPES, supra note 271, at 8.
Wisconsin survey rolled over a payday loan thirty times in one year. The foregoing data strongly suggests that, although the frequency of rollovers may vary, the majority of payday loan customers roll over payday loans. Consequently, despite the industry’s representations, payday loans are not a quick fix to a problem that can be cured in two weeks—the initial term of the payday loan.

Besides the data on the frequency of rollovers, insight into the debt treadmill may be gleaned from several sources. First, the payday loan business model leads to the treadmill because it requires two-week terms (even though most payday loan statutes authorize one-month terms), it prohibits partial payments (so that the loans are nonamortizing), and it requires payment of rollover fees to prevent a default. Moreover, recall the discussion showing that the average payday loan customer earns only low-to-moderate income and, therefore, does not have sufficient disposable income to service debt.

Further insight into the dynamics-of-debt treadmill exists in an ability-to-repay chart prepared by Senator Joseph Lieberman’s staff for a 1999 payday lending forum. The chart computes the amount of income remaining after paying necessary expenses and uses a two-week payroll period because it is the average term for a payday loan. Assuming a payday loan customer earns $1138 every two weeks and owns an outstanding $168 loan, she will have a deficit of $34 if she pays back the loan in full on time. The loan amount derives from data available at

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292. Fox & Mierzwinski, supra note 63, at 6.
293. See Keest, supra note 44, at 1113. Consumer advocates state that the two-week term is required so the “lender can double the finance charge by the simple expedient of writing a two-week loan instead of a one-month loan.” Id.
294. See supra note 276 and accompanying text; infra notes 526-34.
297. Bi-weekly income of $1138 is based on industry data showing that the average income is approximately $35,000. Id. at 1111.
298. The chart reads as follows:

| Annual Household Income Level | $25,000 | $35,000 |
| Two-week net paycheck, (less taxes and retirement) | $847 | $1,138 |
| Essential expenditures (food, housing, utilities, transportation and healthcare only) | $875 | $1,004 |
the time of the forum about the average payday loan amount.\textsuperscript{299} If she instead earns $847,\textsuperscript{300} a more realistic amount,\textsuperscript{301} she will have a deficit of $196 if she pays back the loan in full on time.\textsuperscript{302} Observe that, regardless of income, the consumer cannot repay the loan in full, as required by the contract, and must roll over or go without essentials in order to pay the loan by its original due date. When one takes into account the repayment ability chart, the payday loan business model, the average income data, and the rollover frequency data, one may reasonably conclude that the majority of customers will have to roll over their payday loans.

Note that the rollover data only identify rollovers by customers using the same lender and do not show those that use multiple payday lenders—"the 'borrow from Peter to pay Paul' phenomenon."\textsuperscript{303} While the Ohio Survey could not accurately test the extent to which consumers roll over payday loans using multiple payday lenders, other surveys indicate that it happens frequently.\textsuperscript{304} Of the four research assistants involved in the contract consummation stage of the Ohio Survey, all obtained at least two loans in less than two

<table>
<thead>
<tr>
<th>Net paycheck minus essential expenditures</th>
<th>$28</th>
<th>$134</th>
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<tr>
<td>Average payday loan due at end of pay period</td>
<td>$168</td>
<td>$168</td>
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<tr>
<td>Pay period deficit if payday loan is paid in full on time</td>
<td>$196</td>
<td>$34</td>
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\textit{Id. at 1114.}

\textsuperscript{299} Id.

\textsuperscript{300} Income of $847 is based on non-industry data showing that the average income is approximately $25,000. \textit{See id.} at 1111. The non-industry data is more persuasive. \textit{See id.} at 1111 n.2.

\textsuperscript{301} \textit{See infra} notes 526-41 and accompanying text. The weight of available data shows the average annual income of payday loan customers is approximately $25,000. \textit{Id.}

\textsuperscript{302} Keest, \textit{supra} note 44, at 1113.

\textsuperscript{303} Id. at 1115.

\textsuperscript{304} A survey of households with less than $30,000 in income "found that of households using payday lenders, 11% borrowed from one payday outlet to pay another." \textit{Peter Skillern, CMTY. REINVESTMENT ASS'N OF N.C., HOW PAYDAY LENDERS MAKE THEIR MONEY} 3 (2001), at http://www.cra-nic.org/payday2.htm; \textit{see also} Andrew Conte, \textit{$230 Debt Can Reach $7K-Plus Payday Loans Can Be Deep Trap}, CINCINNATI POST, Feb. 3, 2000 (describing a Cincinnati man who, unable to pay back a $230 loan obtained from one payday lender, took out another loan from a second lender and four months later owed $2,557 to five or more different payday lenders), 2000 WL 3366037; Michael Squires, \textit{TOUGH TIMES: Short-Term Loan Firms Prospering}, \textit{LAS VEGAS REV.}, Dec. 23, 2001 (quoting Michelle Johnson, president of Consumer Credit Counseling Service, who stated that many customers borrow from one payday lender to pay off another), 2001 WL 9545052.
Because the majority (twenty out of twenty-two) of the payday lenders used the services of Tele-Track, a credit reporting agency for sub-prime borrowers, the lenders knew when a research assistant had at least one outstanding loan. The use of Tele-Track was a surprising discovery because payday lenders usually advertise that they do not perform credit checks. In the study, after receiving a loan application and proper documentation, the payday lenders that subscribed to Tele-Track contacted Tele-Track by telephone and, based on the information received, either granted or denied the payday loan. The information that Tele-Track provides to payday lenders is collected and reported to and from merchants who interface with high risk consumers daily, including check advance/deferred deposit/payday loan companies. Tele-Track, Company Information, at http://www.teletrack.com/company.html (last visited Aug. 29, 2002).

Gender may have played a factor in their denial decisions because she was the only female surveyor used in the contract-consummation stage and the other surveyors did not meet the income criteria (i.e., they did not possess check stubs showing three months of full time income). Moreover, these lenders violated the Equal Credit Opportunity Act by denying credit solely on the basis that the applicant had part-time income. Regulation B, 12 C.F.R. § 202.6(b)(5) (2002) (“A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment. ...”). See infra App., tbl.3. Tele-Track “collect[s] and report[s] information to and from merchants who interface with high risk consumers daily, including ... check advance/deferred deposit/payday loan companies.”

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Payday lenders were immediately suspicious of him and refused to give him a loan. Racial stereotyping may have played a factor in their decisions to deny a loan because this research assistant was an African-American male with a mid-size afro hairstyle. Four lenders also denied a female surveyor a loan stating that the reason for the denial was because she had only part-time income. See Surveyor No. 3’s Notes, June 11, 2001 (on file with author). Gender may have played a factor in their denial decisions because she was the only female surveyor used in the contract-consummation stage and the other surveyors did not meet the income criteria (i.e., they did not possess check stubs showing three months of full time income). Moreover, these lenders violated the Equal Credit Opportunity Act by denying credit solely on the basis that the applicant had part-time income. Regulation B, 12 C.F.R. § 202.6(b)(5) (2002) (“A creditor shall not discount or exclude from consideration the income of an applicant or the spouse of an applicant because of a prohibited basis or because the income is derived from part-time employment. ...”). See infra App., tbl.3. Tele-Track “collect[s] and report[s] information to and from merchants who interface with high risk consumers daily, including ... check advance/deferred deposit/payday loan companies.”

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lenders meets the Fair Credit Reporting Act's definition of a "consumer report" because it aids a payday lender in deciding whether to extend credit to a consumer for personal use. Further, Tele-Track's self-description leaves little doubt that it is a consumer-reporting agency. One lender told a research assistant that it used Tele-Track to determine if a customer had any existing loans with that particular lender and to make sure the customer had not defaulted on any previous payday loans with any lender.

lenders gave the research assistants the notices required under the Fair Credit Reporting Act, 15 U.S.C. § 1681m (2000) (requiring creditors to notify consumers before taking adverse action); see also id. § 1681a(k)(iv) (defining "adverse action" to include a determination regarding a consumer's application). Therefore, these payday lenders violated the Fair Credit Reporting Act requirement that creditors provide consumers with notification of an adverse action taken against them if the creditor based the action on information in a consumer report. Id. § 1681m. Section 1681a(d) of the Fair Credit Reporting Act defines a consumer report as follows:

(1) IN GENERAL.—The term "consumer report" means any written, oral, or other communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for the purpose of establishing the consumer's eligibility for—

(A) credit or insurance to be used primarily for personal, family, or household purposes;

(B) employment purposes; or

(C) any other purpose authorized under section 1681b of this title.

Id. § 1681a(d)(1) (footnote omitted).

309. See id. § 1681a(d)(1) (listing in the definition of "consumer reports" credit information obtained to determine whether a consumer is eligible for credit to be used for personal use).

310. A "consumer reporting agency" is any person which, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties, and which uses any means or facility of interstate commerce for the purpose of preparing or furnishing consumer reports.

Id. § 1681a(f).

311. This explanation comports with Tele-Track's website, which states, Tele-Track provides information to identify if an applicant has a history of writing uncollectible checks to check advance [i.e., payday loan] companies, skips on sub-prime finance or rental agreements, or uses a fraudulent social security number to get check advances approved. Tele-Track's unique fraud alert service identifies applicants who have acquired multiple check advances in the last 14 days or have applied at multiple check advance merchants in the past 30 days.

Tele-Track website, http://www.teletrack.com/checkscreen.html (last visited
One research assistant obtained a total of nine loans in three days. Most of the subsequent lenders asked why the researcher needed another loan so soon after the previous one. In response, the research assistant gave various answers such as “The loan I got yesterday wasn’t large enough,” “My paycheck wasn’t big enough,” and “I lost money gambling last night.” Even though Tele-Track informed these lenders about existing payday loans, most granted the loans. With statements such as “It’s none of my business,” some loan clerks ignored signs that a research assistant could be a consumer in grave financial trouble. As discussed later in Part II.B.1.e., ignoring these warning signs violates the industry’s purported commitment to encouraging consumer responsibility. After the ninth loan, the research assistant went to a tenth lender, but this lender refused to lend him money. The lender told the research assistant that he had been “red-flagged” because of his excessive loan activity. Only two weeks later, the same research assistant obtained two more loans from different lenders. Based on these survey results, it is clear that a customer can obtain more than one payday loan from different lenders and that almost all lenders possess knowledge of the customer’s loan activity. Therefore, lawmakers should expand the definition of rollovers to prevent

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312. See supra note 305 (explaining why research assistants obtained so many loans so quickly).
313. See supra note 167 (explaining that research assistants were not wired with any audio or video recording equipment and therefore no direct evidence exists that these statements were made).
314. See supra note 167 (detailing the procedures by which survey information, such as these statements, was recorded).
315. See supra note 311 (stating that Tele-Track “identifies applicants who have acquired multiple check advances in the last 14 days or have applied at multiple check advance merchants in the past 30 days”).
316. See supra note 167 (explaining that research assistants were not wired with any audio or video recording equipment and therefore no direct evidence exists that these statements were made).
317. Supra note 167.
318. See supra note 311 (identifying services and information that Tele-Track provides to lenders through which a loan applicant might be “red-flagged”).
319. Apparently, Tele-Track no longer had this research assistant “red-flagged” because his previous nine loans had cleared Tele-Track’s system in the two-week period. See supra note 311 (stating that Tele-Track’s “fraud audit services” only notes check advances obtained within the last fourteen days). Each research assistant repaid each loan no later than the close of business the day after the loan was obtained.
consumers from staying on the treadmill of indebtedness by using multiple lenders to obtain loans.

c. Current State Law Fails to Address the Rollover Phenomenon

The majority of states that legalize payday lending keep consumers off the payday loan treadmill by prohibiting or limiting rollovers through the same lenders or other lenders.\textsuperscript{320} Kentucky bans payday lenders from charging a fee to “renew, roll over, or otherwise consolidate” payday loans.\textsuperscript{321} Additionally, Kentucky imposes a duty on payday lenders to question potential customers about any outstanding payday loans and to deny a loan to anyone having an outstanding loan with another lender.\textsuperscript{322} Although Kentucky prohibits rollovers, it does allow lenders to issue second loans to their own customers as long as the combination of the loans does not exceed \$500.\textsuperscript{323} Florida law goes one step further and requires payday lenders to verify the existence or nonexistence of a payday loan by accessing the database managed by Florida’s Department of Banking and Finance, which shows all outstanding payday loans.\textsuperscript{324} Some states prohibit rollovers but do not impose on lenders a duty to inquire so as to prevent

\begin{footnotesize}\begin{itemize}
\item[320.] In order to analyze the deficiencies in state payday loan statutes, this Article broadly defines rollovers to include the consumer practice of paying a fee to extend the loan’s due date as well as the practice of refinancing the loan by using either the same or multiple lenders.
\item[321.] KY. REV. STAT. ANN. § 368.100(15) (Michie Supp. 2002).
\item[322.] Id.
\item[323.] Id.
\item[324.] Subparagraphs (19)(a) and (b) of FLA. STAT. § 560.404 require the lender to maintain a database and to consult the state’s database:
\begin{itemize}
\item[(a)] The deferred presentment provider shall maintain a common database and shall verify whether that deferred presentment provider or an affiliate has an outstanding deferred presentment transaction with a particular person or has terminated a transaction with that person within the previous 24 hours.
\item[(b)] The deferred presentment provider shall access the department’s database established pursuant to subsection (23) and shall verify whether any other deferred presentment provider has an outstanding deferred presentment transaction with a particular person or has terminated a transaction with that person within the previous 24 hours. Prior to the time that the department has implemented such a database, the deferred presentment provider may rely upon the written verification of the drawer as provided in subsection (20).
\end{itemize}
\end{itemize}\end{footnotesize}
consumers from obtaining multiple loans with different lenders.\textsuperscript{325} In these states, a lender can issue consumers up to two loans so long as they do not exceed the state's aggregate loan amount.\textsuperscript{326}

Instead of banning rollovers, the remaining states limit rollovers, require a warning in the payday loan contract informing the consumer that rollovers will raise the cost of the original loan, or both.\textsuperscript{327} For example, in Colorado, payday lenders must include the following statement as a part of a warning in all contracts: "RENEWING THE DEFERRED DEPOSIT LOAN RATHER THAN PAYING THE DEBT IN FULL WILL REQUIRE ADDITIONAL FINANCE CHARGES."\textsuperscript{328} In addition, a lender may allow customers to roll over a loan only one time and charge customers a rollover fee equal to the original loan fee.\textsuperscript{329} Colorado only permits "refinancing" if the lender's finance charge is lower than the original loan fee.\textsuperscript{330}

Most state statutes prohibiting or limiting rollovers, however, fail to take into account the determination of payday lenders to circumvent the law and the capabilities of current

\textsuperscript{325} For example, Iowa law does not allow payday lenders to,
a. Hold from any one maker more than two checks at any one time.
b. Hold from any one maker a check or checks in an aggregate face amount of more than five hundred dollars at any one time.
c. Hold or agree to hold a check for more than thirty-one days.
d. Require the maker to receive payment by a method which causes the maker to pay additional or further fees and charges to the licensee or another person.
e. Repay, refinance, or otherwise consolidate a postdated check transaction with the proceeds of another postdated check transaction made by the same licensee.


\textsuperscript{326} See, e.g., id. § 533D.10(1)(b) (establishing the aggregate amount at $500).

\textsuperscript{327} See, e.g., COLO. REV. STAT. § 5-3.1-105 (2001) (limiting the percentage lenders may assess in finance charges on deferred deposit loans).

\textsuperscript{328} See id. § 5-3.1-104.

\textsuperscript{329} See id. §§ 5-3.1-105, 5-3.1-108(1)-(2); see also Howard Pankratz, Colo. Suit Targets Big ‘Payday’ Lender, DENV. POST, July 17, 2001, at A1 ("For a 14-day $500 loan, a $75 fee can be charged, the equivalent of a 391 percent annualized percentage rate. Under Colorado law, that loan can be rolled over once with the lender charging the same fee of $75. After that, the rate drops.").

available at 2001 WL 6757171.

\textsuperscript{330} COLO. REV. STAT. §§ 5-3.1-108(4), 5-2-201(7) (establishing allowable loan finance charges).
technology to aid them in this endeavor. For instance, in Iowa and other states that prohibit rollovers but allow a customer to have two loans with the same lender, lenders could claim technical compliance with the state law prohibition against rollovers while allowing consumers to continually roll an existing loan into a new loan as long as the lender does not exceed the maximum loan amount. This possible end-run around the rollover prohibition prompted the Iowa Division of Banking to issue an interpretive bulletin informing lenders that the prohibition on rollovers means that they cannot issue a new loan to a consumer until at least one day after payment of the previous loan. Given that the Iowa Division of Banking found, in its December 2000 report on payday lenders, that the average customer had 12.5 loans per year, the effectiveness of the bulletin is questionable. Unlike Iowa, other states have not even tried to clarify the interrelationship between statutes that prohibit rollovers and statutes that allow multiple outstanding loans. Therefore, payday lenders in these states may practice rollovers even where it is technically illegal.

In addition to leaving legal loopholes for payday lenders to exploit, some state statutes do not adequately define the prohibited conduct. In a complaint filed recently against ACE Cash Express (ACE), Colorado Attorney General Ken Salazar alleged numerous violations of Colorado’s payday lending

331. See, e.g., IOWA CODE ANN. §§ 533D.10(1)(a)-(b) (2000) (limiting the number of loans a customer can have with one lender to two checks, not exceeding $500 in the aggregate).

332. Thus, a lender who two weeks ago took a customer’s postdated check for a $115 loan can take from the consumer today a new postdated check for $130 (the original $115 loan plus a $15 fee) and still be within the letter of the law limiting the maximum loan amount (for example, $500). See Drysdale & Keest, supra note 16, at 608 n.105 (suggesting that there are loopholes in the Iowa statute prohibiting rollovers (citing LARRY D. KINGERY, IOWA DIV. OF BANKING, DELAYED DEPOSIT SERVICES LICENSES, INTERPRETIVE BULLETIN 1 (Sept. 15, 1997))).

333. Id. Drysdale and Keest, however, note that even this has not been entirely successful. Id. at 608.

334. Keest, supra note 44, at 1114; see also Drysdale & Keest, supra note 16, at 608 (“[E]ven [the interpretive bulletin] has not been a complete success.”).

Colorado accuses ACE of violating section 5-3.1-108(1), which provides that "[a] deferred deposit loan" shall not be renewed more than once. The payday loan statute does not define the term "renewed," and the attorney general's complaint does not describe factually how ACE's renewals take place. One Colorado resident, Cathee Jones, did not technically "renew" a $300 loan that she obtained from Colorado Pay Day Loans Inc., but she wound up "paying back the loan and immediately taking out a new loan for the same amount—eight times." Consequently, ACE could argue that whatever it is doing, it is not bound by Colorado's prohibition against renewals.

Compare Colorado to Ohio. In Ohio, a licensed check-cashing business cannot "[m]ake a loan to a borrower if there exists an outstanding loan between the check-cashing business and that borrower and if the outstanding loan was made pursuant to" Ohio's check-cashing loan law. The legislative history states that the "bill prohibits the 'rolling' of loans, also referred to as 'flipping' when a loan operator issues a loan to

337. Payday loans go by various names. See supra note 34 and accompanying text.
338. Colorado Complaint, supra note 335, ¶ 33 ("[M]any of the loans renewed through ACE were renewed more than once.").
339. See generally Colorado Complaint, supra note 335 (noting allegations that loans were renewed more than once, but not describing how the loans were renewed), http://www.ago.state.co.us/UCCC/acecomplaint.pdf.
341. ACE is defending on the basis that the rollover fees, like the original loan fees, constitute interest and are therefore protected by the preemption doctrine in federal banking law. Long v. Ace Cash Express, No. 3:00-CV-1306-J-25TJL (D. Fla. June 18, 2001) (order granting Plaintiff's motion to remand) (on file with author); see also OCC Weighs in on Payday Lender Case, AM. BANKER, Oct. 3, 2001, at 4 [hereinafter OCC Weighs In] (indicating that ACE claims its "rollovers were made in partnership with Goleta National Bank of California and that they were permitted by the National Bank Act"), available at 2001 WL 26574239. It is argued here that preemption does not apply to rollover fees because they are not included in the OCC's definition of interest. See discussion infra Part III.B.2.
retire a previous loan made by the same operator to circumvent the maximum time limit.\textsuperscript{343} The statute, however, does not address rolling that takes the form of paying a renewal fee to extend the life of the loan.\textsuperscript{344} Also, Ohio and Colorado are evidently seeking to prevent rollovers, but their statutes describe the prohibited conduct differently.\textsuperscript{345} A clever payday lender can arrange the transaction in such a way as to technically fall outside the definition of the applicable statute. For example, one payday lender in the Ohio Survey stated that if the customer could not repay a $50 loan by its original due date, the customer could pay a fee of $2.50 every two days to keep from defaulting on the loan. This clearly constitutes a renewal fee but Ohio's statute does not expressly prohibit this practice.\textsuperscript{346} Nevertheless, the lender may have violated Ohio's check-cashing loan law which limits "interest at a rate of five per cent per month"\textsuperscript{347} and which states that the lender may not "collect, or receive, directly or indirectly, any additional fees or charges in connection with a loan, other than fees and charges permitted."\textsuperscript{348} Because the legislative history expresses a legislative intent to prohibit "rolling,"\textsuperscript{349} the statute should be amended to expressly prohibit rollovers, which take the form of paying a renewal fee to extend the loan's due date. Assuming that a lender's renewal fees violate Ohio's check-cashing loan law, state lawmakers need to amend the statutes to limit or prohibit rollovers to reach rollovers involving multiple payday lenders.

Any proper review of state statutes should ask whether lawmakers in states like Ohio should amend their statutes that regulate rollovers to prevent a consumer from using multiple lenders to keep a loan afloat. Support for such a statutory


\textsuperscript{344} OHIO REV. STAT. ANN. § 1315.40(A).

\textsuperscript{345} Compare COLO. REV. STAT. § 5-6-201 (2000), with OHIO REV. STAT. ANN. § 1315.41.

\textsuperscript{346} OHIO REV. STAT. ANN. § 1315.41.

\textsuperscript{347} Id. § 1315.39(B).

\textsuperscript{348} Id. § 1315.41(C).

expansion may be found in a state's legislative history. In Ohio, the legislature expressed an intent to prohibit rollovers. Implicit in this express intent is the legislature's recognition that consumers need to be protected from perpetual indebtedness to payday loan companies. The payday loan industry's best practices list provides another basis for regulating rollovers using multiple lenders. The industry claims to recognize the need to curb perpetual indebtedness in its best practices list, its response to the concerns of lawmakers and its "commitment to providing substantive consumer protections and ensuring the long-term success of the industry." Payday lenders should therefore be required to comply with a well drafted law that limits or prohibits rollovers.

d. Rollover Business: Payday Lenders Are Blinded by Dollar Signs

While the industry claims it is committed to limiting rollovers and informing consumers of the occasional use of payday loans for a short-term financial crisis, data show that repeat transactions generate a majority of a payday lender's revenue. Data from North Carolina show that during 1999, 22.39% of the roughly 420,000 payday loan customers used a single company only once or twice while 42.41% of the customers transacted with the same payday lender nine or more times and 14.06% did so nineteen or more times. These 420,000 customers generated 2,910,366 payday loan transactions for only 142 lenders. Using this North Carolina data, one financial analyst demonstrated that high-frequency customers generate a disproportionate amount of payday lending revenue.

350. See supra notes 342-49 and accompanying text.
351. See BEST PRACTICES, supra note 154.
353. NORTH CAROLINA PAYDAY LENDING REPORT, supra note 290, at 5, 6 tbl.III(F) (showing 419,601 lenders surveyed), http://www.banking.state.nc.us/reports/ccfinal.pdf (last visited Sept. 20, 2002).
354. Id. at 4.
355. SKILLERN, supra note 304, at 1.
transactions eighteen or more times comprised only 16% of the 420,000 customers but generated 36% of the payday lending revenue in North Carolina. In contrast, 13% of the 420,000 customers who used the transaction only one time generated less than 2% of the revenue. Clearly, one-time users contribute little to the profitability of the North Carolina payday loan industry.

The same results probably hold true for the industry at large, particularly since two very large payday loan companies, Dollar Financial and ACE, withdrew their memberships from the CFSA because they did not want to comply with the best practice standard for rollovers. A few months after Dollar and ACE withdrew their memberships, Eagle National Bank in partnership with Dollar Financial and Goleta National Bank in partnership with ACE announced that they will both require their payday lenders to limit customers to three rollovers. Critics of the industry assert, however, that payday lenders may easily circumvent this self-policing measure by "labeling rollovers as 'new' loans."

The industry alleges that the risk of default is high and therefore justifies its exorbitant fees, but because the rollover

356. Id. Skillern is the executive director of the Community Reinvestment Association of North Carolina. Id. Skillern used revenue data supplied by payday lenders to the North Carolina Banking Commission. Id.; see also NORTH CAROLINA PAYDAY LENDING REPORT, supra note 290, at 5-6, http://www.banking.state.nc.us/reports/ccfinal.pdf (last visited Sept. 20, 2002).

357. SKILLERN, supra note 304, at 3.


360. Id.

361. See, e.g., Carolyn Said, Long Way from Payday, S.F. CHRON., June 17, 2001, at C1 (indicating that the owner of a chain of twenty-two check-cashing and payday loan stores claims his fees are reasonable because of the risk he assumes, even though by his own admission the payday loan stores are the most profitable part of his business); available at 2001 WL 3406626. The true risk of default depends on how one defines default. It appears that the
practice is part of its business model, the risk of losing capital decreases over time. The payday loan business model requires two-week terms even though most payday loan statutes authorize one-month terms. It also prohibits partial payments so that the loans are nonamortizing and requires rollovers so that the customer can keep from totally defaulting on the loan. Again, consider how this business model works in the example of Leticia Ortega and the thousands like her. She still owed National Money Service $300 even though she had paid $1800 in rollover fees, which were deducted from her bank account every two weeks by National Money Service. Ms. Ortega's case shows how the lender's risk of losing capital actually decreases, and how the lender is paid substantially more than the principal borrowed. For many lenders, the business model includes a fourth component of threatening and pursuing criminal prosecution, which dramatically increases the lender's ability to collect rollover fees. As discussed in Part II.B.2.d., because many payday lenders threaten customers with criminal prosecution for writing bad checks and because it is commonly known that writing a bad check is a crime, payday lenders have a powerful tool to successfully intimidate defaulting customers into paying rollover fees. Consequently, through these two practices, lenders greatly decrease the risk of losing capital. Finally, the risk of losing capital cannot be that great when one recognizes that lenders

industry labels default as the customer's inability to repay a loan by the original due date. If that is how the industry defines default, then the risk of default is very high because the rollover data show that most customers have to roll over loans. Given how much money payday lenders make on rollovers, however, default is more appropriately defined as the lender's inability to collect the original loan amount and finance charge. That risk appears to be very low.

362. Keest, supra note 44, at 1113. Consumer advocates state that the two-week term is required so the "lender can double the finance charge by the simple expedient of writing a two-week loan instead of a one-month loan." Id.

363. Id. at 1115.

364. See supra notes 1-10 and accompanying text (describing Ortega's experience with National Money Service).

365. Drysdale & Keest, supra note 16, at 617 n.158. The authors continued,

If a [payday loan] consumer pays a $15 fee to renew an $85 loan every two weeks for four months, she has paid $120 total. The lender has received enough to repay the principal plus a 217% yield on that four-month $85 loan, but if the [traditional] borrower defaults, the full principal is still owed.

Id.; see also SKILLERN, supra note 304, at 3.

366. See infra Part II.B.2.
like Check 'n Go are advertising that if a national bank partners with it, the bank may receive a 20% return on equity. Based on the foregoing, one has to doubt the industry's pledge to limit rollovers.

e. Consumer Responsibility

Related to the discussion of rollover practices is the concept of consumer responsibility. On the one hand, prohibiting rollovers constitutes paternalism and consumers should bear the responsibility for determining how much debt they are willing to accept and how they plan to repay it. On the other hand, the horror stories of huge debts justify such a prohibition and payday lenders should bear some responsibility given that they make no assessment of a consumer's ability to repay, and given that the average payday loan customer lacks access to traditional forms of credit. Without accepting responsibility for a consumer's actions, the industry pledged to limit rollovers and announced its commitment to encouraging consumer responsibility. To achieve the best practice of encouraging consumer responsibility, the CFSA proposed that its members implement policies and procedures that inform consumers of the intended use of payday loans as a short-term cash-flow solution, not as a tool for managing long-term financial problems.

As revealed by the Ohio Survey, however, the industry practice belies its commitment to inform consumers that payday loans are intended only as a short-term solution. First, payday lenders advertise that consumers can obtain, in minutes, payday loans or credit checks without hassles and without being asked why the loans are needed. Plus, the

367. The advertisement stated in relevant part, What Would Your Bank Consider To Be A Good ROE? Now Double That. Your company could realize an annual 20+% return on equity through a strategic alliance with Check 'n Go.

368. See supra notes 35-39 and accompanying text; infra notes 747-49 and accompanying text.

369. See infra notes 537-47 and accompanying text.

370. BEST PRACTICES, supra note 154, at 1.

371. Id.

372. For example, Check$mart's website contains the following: At Check$mart we will pay up to $500 against your personal check!
loan applications obtained in the Ohio Survey only requested information about income, not expenses.\(^{373}\) Therefore, the lender does not typically know the consumer’s debt-to-income ratio and cannot assess the customer’s ability to repay. Through these practices, payday lenders embrace a willful ignorance of relevant information and, consequently, will not know whether a consumer inappropriately seeks a payday loan as a temporary fix for a long-term financial problem. These practices can hardly be considered the “best practice” of informing the consumer to use the payday loan as a solution for a short-term problem.

Second, the Ohio Survey revealed that several payday lenders offered reward programs for repeat customers. For example, after issuing a payday loan, Kentucky Check Exchange gave one research assistant a coupon entitling him to $5 off his next payday loan.\(^{374}\) Another payday lender stated that it awards a free music compact disc after the customer obtains the fifth payday loan.\(^{375}\) ACE, America’s largest check-casher issuing payday loans, handed one surveyor a sheet entitled “ACE PLUS BONUS POINTS.”\(^{376}\) Under this reward

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**Check$$mart** never asks you to explain the reason why you need the cash.

Check$$mart website, at http://www.checksmart.com (last visited Aug. 24, 2002); see also Check Into Cash, Inc., *How Do I Get Started?*, at http://www.checkintocash.com/how_it_works.htm (last visited Aug. 24, 2002) (“Check into Cash is perfect for times when your budget is stretched by unexpected expenses. Such as . . . car repairs, medical expenses, home emergencies, or maybe you're just trying to get in on a great sale.”).

373. See, e.g., First American/Southern Cash Advance, Membership Application (requesting information about income and no information about expenses) (on file with author).

374. The company’s name listed on the coupon is “Check Exchange, Inc.” Check Exchange Coupon (on file with author).

375. See supra note 167 (explaining that the surveyors were not wired with any audio or video recording equipment and therefore no direct evidence exists that this statement was made).

376. ACE America’s Cash Express, ACE Plus Bonus Points (on file with author).
program, a customer receives “2 BONUS POINTS FOR EACH DOLLAR BORROWED” and 1000 bonus points when a payday loan is repaid on time. A customer may receive a reward at four different levels. Upon obtaining 20,000 points, which is the highest reward level, the customer is entitled to a ten-minute prepaid telephone card and “$10 CASH NOW!” Clearly, this program rewards the habitual payday loan customer. The program does reward timely repayment, but the consumer may borrow from another lender to pay off ACE.

Third, the practice of up-selling also demonstrates that payday lenders do not adhere to the best practice of fostering consumer responsibility. In order to preserve limited research funds, the Ohio Survey restricted research assistants to borrowing only $50, yet two payday loan companies made the research assistants take out $100 loans. Perhaps these lenders wanted to assure themselves of making at least a $15 revenue on each payday loan transaction. At many of the payday loan outlets, the clerk tried to persuade the research assistants to take out the maximum loan amount for which they were approved. While it is a normal business tactic, up-selling belies the industry’s purported commitment to the best practice of encouraging consumer responsibility. This is

377. Id.
378. Id.
379. Id.
380. See supra notes 303-08 and accompanying text (discussing rollovers by customers using multiple payday lenders—the “borrow from Peter to pay Paul” phenomenon); supra note 335 and accompanying text (noting that ACE, along with Dollar Financial, withdrew its membership from CFSA because it did not want to follow the best practice of limiting rollovers to four times).
381. The loan documents on file with the author show that two loans were taken out in the amount of $100.
382. A $50 loan would yield $7.50.
383. See supra note 167 (explaining that the surveyors were not wired with any audio or video recording equipment and therefore no direct evidence exists that this statement was made).
384. The industry is supposed to implement its best practice of encouraging consumer responsibility by establishing policies and procedures that inform consumers of the intended use of payday loans as a short-term cash-flow solution. BEST PRACTICES, supra note 154. Encouraging customers to take out the maximum loan amount appears to be a type of up-selling practice that urges customers to misuse the stated purpose of payday loans and may result in long-term financial problems. While up-selling is a common practice in America, it is normally considered a deceptive or predatory practice. See Deborah Goldstein, Note, Protecting Consumers from Predatory Lenders:
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particularly true given the industry’s business practices of refusing to ask the customer for the purpose of the loan, getting only partial information about the customer's ability to repay, and establishing reward programs for repeat customers.385

Finally, the use of Tele-Track demonstrates that payday lenders are not committed to encouraging consumer responsibility. As explained previously, the majority (twenty out of twenty-two) of the payday lenders used the services of Tele-Track and, therefore, knew when a research assistant had at least one outstanding loan.386 Each of the four research assistants, however, obtained at least two loans in less than two hours.387 Even though Tele-Track informed these lenders about existing payday loans, most granted the loans.388 When these lenders granted loans even though they knew about pre-existing loans, these lenders were turning a blind eye to a consumer with potentially major financial problems,389 and evincing their intention not to follow the best practice of implementing “procedures to inform consumers of the intended use of the payday advance service.”390 Not once did a payday loan clerk advise a research assistant to seek credit counseling services even though “informing customers of the availability of credit counseling services” represents a best practice procedure

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385. See supra notes 372-84 and accompanying text.
386. See infra App., tbl.3.
387. See supra note 305 (explaining why the surveyors obtained so many loans so quickly).
388. See supra notes 305-19 and accompanying text (explaining the use of Tele-Check and how red-flagging was used to deny one surveyor a loan for a two-week period).
389. Most of the lenders who knew about a pre-existing loan asked why the researcher needed another loan so soon after the previous one. In response, the research assistant gave various answers such as, “The loan I got yesterday wasn’t large enough,” “My paycheck wasn’t big enough,” and “I lost money gambling last night.”
that the CFSA endorses.\footnote{Id.}

In summary, in light of the Ohio Survey's results, the business model of payday lenders, the data about multiple rollovers, and the vulnerability of payday loan customers, lawmakers should actualize the industry's ostensible commitment to encouraging consumer responsibility and limiting rollovers. A number of states recognize that consumers who use payday loan services need to be protected from perpetual indebtedness and have passed statutes limiting or prohibiting rollovers.\footnote{See, e.g., ARK. CODE ANN. § 23-52-106(n) (Michie 2000) (prohibiting renewals); COLO. REV. STAT. § 5-3.1-108(1) (2001) (prohibiting consumers from renewing loans more than once, and requiring the consumer to pay the debt in cash or its equivalent after such renewal); FLA. STAT. ANN. § 560.408(1)(b) (West Supp. 2002) (stating that the statute bans rollovers); LA. REV. STAT. ANN. § 9:3578.6(7) (West Supp. 2002) (prohibiting a licensee from renewing or rolling over a deferred presentment transaction or small loan); MONT. CODE ANN. § 31-1-723(15) (2001) (prohibiting the renewal of a loan with the proceeds of another loan made to the same consumer); N.D. CENT. CODE § 13-08-12(12) (Supp. 2001) (prohibiting lenders from renewing payday loans more than once); S.D. CODIFIED LAWS § 54-4-65 (Michie Supp. 2002) (prohibiting payday lenders from renewing or rolling over loans more than four times).}

Nevertheless, most statutes do not define rollovers broadly enough to cover the various forms they take or to cover the use of rollovers with different lenders.\footnote{See, e.g., ARK. CODE ANN. § 23-52-102 (Michie Supp. 2001) (lacking a definition of the term "renew"); COLO. REV. STAT. § 5-3.1-102 (lacking a definition of the term "renewal"); FLA. STAT. ANN. § 560.103 (West 1997) (lacking a definition of "rollovers"); LA. REV. STAT. ANN. § 9:3578.3 (West 1997) (lacking a definition for the terms "renew" or "rollover"); MONT. CODE ANN. § 31-1-202 (2001) (lacking a definition of "renew"); N.D. CENT. CODE § 13-08-01 (Supp. 2001) (lacking a definition of "renew" or "rollover"); S.D. CODIFIED LAWS § 54-1-1 (Michie 1990) (lacking a definition of "renewal"); UTAH CODE ANN. § 7-23-102(5) (Supp. 2002) (defining a "rollover" as the extension or renewal of the term on a payday loan).}

Accordingly, lawmakers need to broadly define rollovers and either limit or prohibit them. To regulate rollovers using multiple lenders, lawmakers should look to Kentucky or Florida for guidance. Kentucky law requires payday lenders to inquire about outstanding payday loans and to deny loans to those with outstanding debt.\footnote{KY. REV. STAT. ANN. § 368.100(11) (Michie 2002) (stating that if the customer has only one outstanding loan in an amount less than $500, the payday lender may lend the customer an amount that, when combined with the other loan, does not exceed $500).} Florida law requires payday lenders to access a state-managed database and verify that
customers do not have outstanding debt before issuing the payday loans.\textsuperscript{395}

2. Inappropriate Collection Practices

While the payday loan industry's rollover practices alone merit legislative attention, its collection practices, in some respects, require more attention because they subject payday loan customers to horrific collection practices not imposed on consumers who default on traditional forms of credit.\textsuperscript{396} Under the best practices list adopted by the CFSA, members pledge to follow appropriate collection practices.\textsuperscript{397} Using the Fair Debt Collection Practices Act as a guideline, members pledge to be fair, lawful, and professional in debt collecting and to avoid using unlawful threats, harassment, or intimidation.\textsuperscript{398} Members also pledge to follow the best practice of not threatening or seeking criminal action against customers who fail to repay loans.\textsuperscript{399} Yet the Ohio Survey obtained loan applications containing clauses not germane to traditional unsecured loans that appear to have the purpose of providing the lenders with enough information to enable them to harass consumers who have defaulted on loans.\textsuperscript{400} For example, one lender required that the consumer waive any privacy claims against the lender,\textsuperscript{401} another lender requested that the consumer describe her "sex, hair color, eye color, height, and weight,"\textsuperscript{402} and another lender asked that the consumer provide the make, model, year, and color of his automobiles.\textsuperscript{403}

\textsuperscript{395} FLA. STAT. ANN. § 560.404(19)(a)-(b).
\textsuperscript{396} See infra notes 405-514 and accompanying text.
\textsuperscript{397} BEST PRACTICES, supra note 154.
\textsuperscript{398} Id.
\textsuperscript{399} Id.
\textsuperscript{400} The Ohio Survey could not accurately gauge how many applications contained these types of provisions because the majority (68%) of the payday lenders would not allow the customer to take a copy of the application. See infra App., tbl.1.
\textsuperscript{401} Cashland Payday Loan Application (on file with author). Cashland's application states, "I waive any privacy claims against Cashland, Inc." \textit{Id}.
\textsuperscript{402} Checkland Payday Loan Application (on file with author). Although these inquiries may be unnecessary because the same information can be retrieved from the photocopy of the applicant's driver's license, the payday lender undoubtedly wants the most current description of the applicant.
\textsuperscript{403} First Check Cash & Advance Payday Loan Application (on file with author).
Complaints of inappropriate collection practices fall into four areas: harassing customers and their employers and relatives with vexing telephone calls; threatening violence against customers unable to repay; collecting excessive damages from customers; and threatening criminal prosecution against those who fail to repay.\(^{404}\) This section of the Article limits its discussion to collecting excessive damages and threatening criminal prosecution because more data is available about these practices and both result in grave consequences for defaulting payday loan customers. Data discussed in this section raise the specter of predatory collection practices and underscore why federal legislation is needed to curb such practices.

**a. Payday Lenders’ Collection of Treble Damages**

Payday lenders collect excessive damages in lawsuits against defaulting customers.\(^{405}\) As an example, consider the fate of one Illinois debtor who defaulted on a payday loan of $240 ($200 loan, $40 fee).\(^{406}\) The payday lender sued seeking a total of $1260, which equaled the $240 loan, plus $720 in treble damages (under the Illinois bad-check law), and $300 in attorney’s fees.\(^{407}\) The practice of collecting treble damages exists in several states,\(^{408}\) and has come under particular scrutiny in the state of Ohio.\(^{409}\)

Under Ohio law, a victim of a bad-check crime may collect $200 or treble damages, whichever is greater, in a lawsuit.

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\(^{404}\) See, e.g., GALLAGLY & DERNOVSEK, supra note 295 (stating that payday lending abuses include the “[a]gressive pursuit of late accounts, including prosecution under ‘bad check’ laws and notification of employers”).


\(^{406}\) Drysdale & Keest, supra note 16, at 612 n.127.

\(^{407}\) Id.

\(^{408}\) See, e.g., id. at 612 & n.127 (discussing payday lenders in Illinois, and lawsuits filed by payday lenders in Indiana); see also Conte, supra note 304 (discussing treble damages under Ohio law).

\(^{409}\) See Teresa Dixon Murray, *State Law Will Help ‘Payday’ Debtors*, PLAIN DEALER (Cleveland), May 2, 2000, at 1C (quoting the director of consumer protection for the Consumer Federation of America who said that it “hear[s] more complaints about this from Ohio than from anywhere else.”), 2000 WL 5148638.
against the debtor. Prior to a 2000 amendment, payday lenders would take advantage of this law, and defaulting customers found themselves indebted to payday lenders for more than three times the original loans. In a study conducted by the Legal Aid Society of Dayton, investigators discovered 381 lawsuits filed in Dayton Municipal Court by five payday lenders against payday loan debtors and found that these debtors were liable for judgments averaging $749, comprised of treble damages, 10% interest, and court costs. Furthermore, most of the lawsuits ended in default judgments, and in 60% of them, courts issued garnishment orders against the debtors to ensure collection of the judgments by the payday lenders. In a similar study of lawsuits filed in Hamilton County Municipal Court, at least twelve payday lenders filed more than 365 complaints over a four-year period, some of them seeking treble damages. The Cincinnati Post conducted a random sampling of the lawsuits and discovered that courts awarded 65% of the payday lenders an average judgment of $930. Moreover, in 46% of the cases won by lenders, courts issued garnishment orders against the debtors.

CFSA best practice number seven states that the payday lender will collect debts in a "fair and lawful manner." Although collecting treble damages may technically be legal, the practice of using a victim's compensation statute to collect treble damages is unfair, especially given that payday lenders do not conduct a pre-loan assessment of the debtor's ability to repay, and no alternative means of getting a short-term loan

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412. Id.
413. Id.
414. Id.
415. Conte, supra note 304.
417. Conte, supra note 304.
418. BEST PRACTICES, supra note 154.
419. See supra notes 372-73 and accompanying text (discussing deficiencies
exist for the majority of payday loan customers. Moreover, payday lenders generate substantial revenue from rollovers. Because payday lenders do not assess a customer's ability to repay, and because they know that the post-dated checks they receive are not good, payday lenders can hardly be classified as crime victims entitled to collect treble damages.

b. One State's Attempt to Prohibit the Collection of Treble Damages

Recognizing that payday lenders were taking advantage of the crime victim's compensation statute, the Ohio legislature amended its payday lending law in 2000 to prevent lenders from using the statute to collect treble damages. The trade association for Ohio payday lenders approved of this amendment, implying that they would encourage their members to comply with the law. However, the Ohio Survey uncovered payday loan documents suggesting that payday lenders may pursue treble damages in cases of default. Checkland's application cites section 2307.61, the Ohio victim's compensation statute, and states, "I understand I may be sued for 3 times the amount of the check or $200.00 whichever is greater." Express Payroll Advance's loan contract states that it is a member of the CFSA, cites to the same Ohio statute, and provides, "You may be sued for 3 times the amount or $200.00

420. See infra notes 517-46 and accompanying text (discussing the limited borrowing opportunities available to payday loan customers).

421. See supra notes 365-67 and accompanying text (detailing revenue data).

422. See supra notes 372-73 and accompanying text (discussing the deficiency of payday lenders in assessing customer's ability to repay). Because of the payday loan business model, see supra notes 34-45 and accompanying text, payday lenders know the customers' checks are drawn on accounts with insufficient funds.

423. Ohio law now makes it unlawful for a payday lender to "collect treble damages pursuant to division (A)(1)(b)(ii) of section 2307.61 of the Revised Code in connection with any civil action to collect a loan after a default due to a check, negotiable order of withdrawal, share draft, or other negotiable instrument that was returned or dishonored for insufficient funds." OHIO REV. CODE ANN. § 1315.41(D) (Anderson 2001). Section 2307.61(A)(1)(b) allows a victim of a theft crime to collect $200 or treble damages as liquidated damages, whichever is greater. The amendment does not limit the rights of other holders of bad checks to seek treble damages.


425. Checkland Payday Loan Application (on file with author).
PAYDAY LOANS

whichever is greater, if the check is returned." Another lender, EZ Cash Advance, may be attempting to skirt the new law by stating that the customer could be liable for double damages upon default, even though no Ohio law entitles it to such damages. Its application contains a holding agreement stating that the defaulting customer may have to pay "[o]ne hundred dollars or two times the face amount of the check, whichever is more by award of the court." The Ohio Survey could not gauge the extent to which Ohio lenders are claiming the ability to collect treble damages, partly because the majority of the payday lenders refused to provide copies of the loan applications signed by the researchers who obtained loans. Because the Ohio Survey could not test for compliance with Ohio's prohibition on the collection of treble damages, no one knows whether these lenders would seek double or treble damages on defaulted loans, or whether these provisions in the loan documents are simply false representations designed to intimidate consumers into timely loan repayment.

Payday lenders who threaten or represent the ability to collect treble damages under Ohio law breach the industry's commitment to follow appropriate collection practices set forth in Ohio's Fair Debt Collection Practices Act (FDCPA). Ordinarily, payday lenders do their own debt collection work and are therefore not considered "debt collectors" under the FDCPA definition. Nevertheless, the industry purportedly

427. If it sought double damages, EZ Cash Advance might be in violation of section 1315.39(B), which limits "interest at a rate of five per cent per month," and section 1315.41(C), which states that the lender may not "collect, or receive, directly or indirectly, any additional fees or charges in connection with a loan, other than fees and charges permitted by" Ohio's check-cashing loan law. OHIO REV. CODE ANN. § 1315.39(B)-(C) (Anderson Supp. 2000).
428. EZ Cash Advance Payday Loan Application (on file with author).
429. See infra App., tbl.1; see also supra note 168 (explaining how applications were obtained even though lenders refused to provide copies of them).
430. The FDCPA was designed "to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses." 15 U.S.C. § 1692(e) (2000).
431. See id. § 1692a(6) (stating that FDCPA covers third-party debt collectors). Note that attorneys for debt collectors engaged in litigation are subject to the provisions of the FDCPA. Heintz v. Jenkins, 514 U.S. 291, 294
committed to follow the FDCPA, and by implication, the collection practices it recommends. Under the FDCPA, a debt collector cannot threaten to take action that could not legally be taken, or use false representations or deceptive means in attempting to collect a debt.

In Edwards v. McCormick, a recent Ohio case analogous to the issue at hand, the plaintiffs asserted that the defendant made an improper threat in violation of the FDCPA when he mailed a letter claiming a right of foreclosure under state law. The letter provided in relevant part, "This creates a lien on all real property in which either or both of you have an interest, and if foreclosed upon may result in the forced sale of those properties. If you wish to avoid this you must contact this office to arrange payment of this judgement." The court found that the claimed right was prohibited under state law and highlighted the defendant's admission that he never foreclosed upon the residential property of consumer debtors.

Using the "least sophisticated consumer" standard to judge a violation of the FDCPA, the court found that the defendant "violated [the FDCPA] in that he threatened [p]laintiffs with an action which he had no intention of taking, and indeed which he could not legally take." The court also found that the defendant violated the FDCPA because his letter falsely represented that it had the right to foreclose on the plaintiffs' home.

Like the defendant in Edwards v. McCormick, Ohio

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432. Prohibited conduct includes "[t]he threat to take any action that cannot legally be taken or that is not intended to be taken." 15 U.S.C. § 1692(e)(5).

433. Prohibited conduct includes "[t]he use of any false representation or deceptive means to collect or attempt to collect any debt or to obtain information concerning a consumer." Id. § 1692e(10).


435. Id. at 804-05.

436. Id. at 805.

437. The "least sophisticated consumer" standard was adopted by the United States Court of Appeals for the Sixth Circuit in Smith v. Transworld Sys., Inc., 953 F.2d 1025, 1028 (6th Cir. 1992).


439. Id. (citing Pipiles v. Credit Bureau of Lockport, Inc., 886 F.2d 22, 25-26 (2d Cir. 1989), which found "a violation of [15 U.S.C.] section 1692e(5) and (10) [where the] clear import of the language, taken as a whole, [was] that some type of legal action ha[d] already been or [was] about to be initiated and [could] be averted from running its course only by payment").
lenders, such as Checkland and Express Payroll Advance,\textsuperscript{440} violate the FDCPA because they incorrectly represent that they have the right to collect treble damages and that the debtors may be liable for three times the amount of the payday loan. Failure to comply with the FDCPA constitutes a failure to follow the industry's best practices standard and is further evidence that the industry cannot regulate itself and is in need of federal regulation.\textsuperscript{441} Many states allow the collection of treble damages for payment of debts arising out of bad-check law violations,\textsuperscript{442} but only a few states have passed legislation to prevent payday lenders from taking advantage of such statutes.\textsuperscript{443}

c. Ohio's New Statute Provides an Inadequate Model

The Ohio legislature should be commended for amending the law to prohibit payday lenders from taking advantage of a statute that allows crime victims to collect treble damages, but this amendment does not address the scope of the problem of

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\textsuperscript{440} Both are members of CFSA and are therefore supposedly committed to following the FDCPA.
\textsuperscript{441} As stated earlier, members of CFSA have pledged a commitment to using the FDCPA as a guideline for fair, lawful, and professional debt collecting. BEST PRACTICES, supra note 154.
\textsuperscript{443} See, e.g., OHIO REV. CODE ANN. § 1315.41(D) (Anderson 2001) (banning a payday lender from collecting treble damages under section 2307.61(A)(1)(b)(ii)). Unlike Ohio, Colorado and Tennessee narrowed the scope of remedies that are available to payday lenders. COLO. REV. STAT. § 5-3.1-112 (2001) (stating that "the lender shall have the right to exercise all civil means authorized by law to collect the face value of the instrument; except that the provisions and remedies of section 13-21-109," which includes treble damages, are not available to the lender); TENN. CODE ANN. § 45-17-112(i) (2000) (stating that payday lenders cannot collect, inter alia, treble damages or attorney's fees). In contrast to Ohio, Colorado, and Tennessee, a few states give a payday lender the right to pursue all available civil remedies, which may include treble damages. See, e.g., ARIZ. REV. STAT. § 6-1260(J) (West Supp. 2001). The Arizona statute states as follows:

If a check is returned to the licensee from a payer financial institution due to insufficient funds, a closed account or a stop payment order, the licensee may use all available civil remedies to collect on the check including the imposition of the dishonored check fee prescribed in § 44-6852.

Id.
\end{footnotesize}
inappropriate collection practices. Section 2307.61(A)(1) of the Ohio Revised Statutes permits a victim of a bad-check crime to recover actual damages or liquidated damages amounting to three times the amount of the check or $200.00, whichever is greater.\(^4\) The amendment to the payday loan statute expressly disallows the collection of treble damages but makes no mention of the $200 liquidated damage.\(^4\) The loan documents of Checkland and Express Payroll Advance state that the defaulting customer may be liable for $200.\(^4\) If a customer defaults on a $50 payday loan, a payday lender could use section 2307.61(A)(1)(b) to collect $200—four times the original loan.\(^4\) For a $75 loan, the lender could recover $200—almost three times the original loan. The amendment to the payday loan statute, therefore, fails to protect customers who default on small loans from paying excessive (quadruple or

444. Section 2307.61(A)(1)(b) stipulates the property owner's recovery as follows:

(b) Liquidated damages in whichever of the following amounts is greater:
   (i) Two hundred dollars;
   (ii) Three times the value of the property at the time it was willfully damaged or was the subject of a theft offense, irrespective of whether the property is recovered by way of replevin or otherwise, is destroyed or otherwise damaged, is modified or otherwise altered, or is resalable at its full market price. This division does not apply to a check, negotiable order of withdrawal, share draft, or other negotiable instrument that was returned or dishonored for insufficient funds by a financial institution if the check, negotiable order of withdrawal, share draft, or other negotiable instrument was presented by an individual borrower to a check-cashing business licensed pursuant to sections 1315.35 to 1315.44 of the Revised Code for a check-cashing loan transaction.

OHIO REV. CODE ANN. § 2307.61(A)(1)(b) (emphasis added); Buckeye Check Cashing, Inc. v. Proctor, No. 98AP-1103, 1999 WL 394884, at *3 (Ohio Ct. App. June 15, 1999) (holding that a "property owner may elect to recover either compensatory damages pursuant to [section] 2307.61(A)(1)(a), or liquidated damages pursuant to [section] 2307.61(A)(1)(b)”).

445. Under Ohio law, a payday lender cannot "[c]ollect treble damages pursuant to division (A)(1)(b)(ii) of section 2307.61 of the Revised Code in connection with any civil action to collect a loan after a default due to a check, negotiable order of withdrawal, share draft, or other negotiable instrument that was returned or dishonored for insufficient funds." OHIO REV. CODE ANN. § 1315.41(D) (Anderson 2002).

446. See supra notes 425-26 and accompanying text.

447. See supra note 444 (stating that section 2307.61(A)(1)(b) allows a victim of a theft crime to collect the greater of $200 or treble damages as liquidated damages).
triple) damages. As explained later, payday lenders are not victims of bad-check crimes and therefore should not be able to collect $200 from a person who borrowed $50.\textsuperscript{448} One may argue that a lender would not litigate just to collect an extra $200. On the contrary, a lender may be highly motivated to litigate because section 2307.61(A)(2) of the Ohio Revised Statutes allows the victim of a theft offense to recover reasonable administrative costs, which may include the cost of maintaining a civil action and attorney's fees.\textsuperscript{449} Payday lenders can then continue their practice of seeking garnishment orders against debtors to ensure collection of their judgments.\textsuperscript{450} Thus, Ohio's amended payday loan statute leaves a lender with an economic incentive to pursue collection under section 2307.61(A)(2) and fails to protect certain customers from paying damages three or more times the original loan.

The amended payday loan statute also unfairly gives payday lenders the ability to shift litigation costs onto defaulting customers and incorrectly assumes that the mere issuance of a post-dated check to a payday lender is a bad-check crime.\textsuperscript{451} One may reasonably conclude that section 2307.61 is a statute designed to protect victims of “willful” offenses. The heading to section 2307.61 provides in relevant part, “Property owner may recover for willful damage or theft.”\textsuperscript{452} One court interpreting a statute similar to section 2307.61 recognized that it is “a punitive statute intended to deter the wrongdoer and others from engaging in similar future conduct.”\textsuperscript{453}

\textsuperscript{448} See infra notes 491-99 and accompanying text.
\textsuperscript{449} OHIO REV. CODE ANN. § 2307.61(A)(2).
\textsuperscript{450} For further discussion on garnishments in lawsuits to collect payday loans, see supra notes 414-17 and accompanying text.
\textsuperscript{451} See infra notes 458-59, 491-99 and accompanying text; infra text accompanying note 460.
\textsuperscript{452} OHIO REV. CODE ANN. § 2307.61.
\textsuperscript{453} Hart Conversions, Inc. v. Pyramid Seating Co., 658 N.E.2d 129, 131 (Ind. Ct. App. 1995) (interpreting Indiana Code, section 34-4-30-1, and holding that the right to treble damages under the statute is personal and not assignable). Section 34-4-30-1, as then interpreted by the court, provided, If a person suffers a pecuniary loss as a result of a violation of I.C. 35-43 [bad check law], he may bring a civil action against the person who caused the loss for:
(1) an amount equal to three (3) times his actual damages;
(2) the costs of the action;
(3) a reasonable attorney's fee.
Assume a payday lender has filed a lawsuit against an individual who defaulted on a $50 payday loan. The lender could rely on section 2307.61 to recover $450—the combination of $200 as compensatory damages, $50 as court costs, and $200 as attorney’s fees. By prohibiting the collection of treble damages under section 2307.61(A)(1)(b)(ii), but remaining silent about the statutory language allowing fee-shifting and a $200 damage award, the Ohio legislature implicitly condones the fee-shifting and damage award as a fair collection practice.

Payday lenders should not be able to recover anything under section 2307.61 or other similar statutes because they are not victims of a willful theft crime; these lenders take a postdated check from a consumer knowing the check is not good, and they issue a loan without doing any pre-loan assessment of the consumer’s ability to repay. As discussed in the next section, Ohio case law makes it clear that a debtor does not commit the crime of passing a bad check if the payee takes a post-dated check with knowledge that the debtor has insufficient funds in her account to cover the check. Because the Ohio amended payday loan statute does not comport with judicial precedent, it leaves a loophole for payday lenders to exploit consumers and therefore should not be followed as the best model of prohibiting the collection of excessive damages.

d. Payday Lenders Threaten Criminal Prosecution Against Customers

State lawmakers seeking to afford their citizens the greatest consumer protection not only need to close the loophole that allows payday lenders to collect excessive damages but also need to close any loophole that allows lenders to use the criminal justice system as a collection agency. Because payday lenders usually issue loans via post-dated checks, one should not be surprised to discover that many payday lenders threaten customers who fail to timely repay with criminal prosecution for writing bad checks. Naturally, the threat of imprisonment embodies a powerful debt collection tactic.

Id. at 130 n.1.
454. OHIO REV. CODE ANN. § 2307.61.
455. See infra notes 478, 491-99 and accompanying text.
456. While payday lenders generally require postdated checks, payday lending over the Internet is a growing business, and practical realities preclude Internet lenders from taking post-dated checks.
457. See discussion infra Part II.B.2.d.
because most people know that writing a bad check is a crime, and therefore will find a way to repay the loan to avoid going to jail.\textsuperscript{458} To curb this abusive collection practice, members of the CFSA have pledged to follow the best practice of not threatening or seeking criminal action against customers who fail to repay loans.\textsuperscript{459} No study could adequately test industry compliance with this best practice because participants would have to risk going to prison and damaging their credit histories to test such compliance. Nevertheless, available evidence shows that payday lenders threaten prosecution across the nation—even in jurisdictions where governmental attorneys will not pursue bad-check convictions against payday borrowers.\textsuperscript{460} In other jurisdictions, some prosecutors and judges unwittingly assist payday lenders in abusing bad-check statutes because the prosecutors and judges fail to distinguish payday loan cases from typical bad-check cases.\textsuperscript{461}

While a number of prosecutors do not allow payday loan debtors to be prosecuted for bad-check crimes,\textsuperscript{462} no shortage of

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\item[458.] Drysdale & Keest, supra note 16, at 610; Karen Gross, The Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions, 65 NOTRE DAME L. REV. 165, 191 (1990) ("[Creditors collect] because debtors fear the consequences of being charged and convicted of a crime. The bad check laws are criminal laws in name but not in purpose.").
\item[459.] BEST PRACTICES, supra note 154.
\item[460.] See infra notes 466-71 and accompanying text.
\item[461.] Using state courts and criminal laws to facilitate debt collection is not unique to payday lending. See Philip J. Hendel & Joseph H. Reinhardt, Inhibiting Post-Petition "Bad Check" Criminal Proceedings Against Debtors: The Need for Flexing More Judicial Muscle, 89 COM. L.J. 236 (1984); Donald J. Schutz, Bankruptcy and the Prosecutor: When Creditors Use Criminal Courts to Collect Debts, FLA. B.J., May 1985, at 11 (stating that creditors "further collection efforts by threatening criminal prosecution of a debtor" and that writing bad checks is the most common crime of a debtor).
\item[462.] Tracey Bruce, Small-Loan Firms Showing Growth in County, ST. LOUIS POST-DISPATCH, Sept. 18, 2000 (quoting senior counsel for Missouri's Division of Finance as stating that while a few prosecutors bring bad-check charges against customers who default on payday loans, most write a letter on behalf of the loan company without bringing any action, and some even inform payday lenders that the prosecutor is not a collection agency), 2000 WL 3548643; Dave Hosick, Some Payday Loans Are Ruled Illegal, EVANSVILLE COURIER & PRESS (Evansville, Ind.), Jan. 20, 2000 (quoting Vanderburgh County Superior Court Judge Maurice O'Connor as stating that local judges have ceased progress on payday loan cases in anticipation of the attorney general's ruling making payday loans illegal), 2000 WL 11829105; Steve Jordon, Quick Cash, High Fees: More Are Using Loans to Make It to Next Payday, OMAHA WORLD-HERALD, Apr. 9, 2000 (indicating that a Douglas
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stories exists about payday lenders filing criminal complaints and threatening consumers with criminal prosecution.\textsuperscript{463} A state regulator in Texas discovered that in one year, payday lenders filed over 13,000 criminal complaints against customers who defaulted on payday loans in one Dallas precinct alone.\textsuperscript{464} In Alabama, a nineteen-year-old working mother had to post bail to get out of jail after a payday lender had her arrested for defaulting on a $200 loan carrying a 520\% APR.\textsuperscript{465} In Florida, a Hispanic woman stated that payday lenders threatened to have her deported or imprisoned unless she repaid the loan.\textsuperscript{466} In Kentucky, a few borrowers were arrested even though most judges and prosecutors took the position that payday loan transactions were not subject to bad-check laws.\textsuperscript{467}

County, Nebraska prosecutor concluded that post-dated checks are promissory notes, rather than checks covered by the criminal bad-check statute because he recognized the difficulty of proving criminal intent when the payee knows the check is not good, 2000 WL 4360924; Bruce Ross, 650 Percent Interest, SANTA FE NEW MEXICAN, Apr. 2, 2000 (stating that Santa Fe’s chief deputy district attorney was not aware of any payday loan check cases handled by his office), 2000 WL 20615658; Larry Rulison, Regulator Says Payday Lenders Abusing Courts, BALTIMORE BUS. J., July 14, 2000, http://www.bizjournals.com/baltimore/stories/2000/07/17/newscolumn1.html (noting that Maryland’s Commissioner of Financial Regulation stated that bad checks originating from payday loans are not enforceable in court).

\textsuperscript{463} Jim Leusner, Florida Will Join County in Payday Loan Lawsuit, THE ORLANDO SENTINEL, Feb. 7, 2001 (reporting that the state of Florida joined a class action lawsuit in which one plaintiff who borrowed money from ACE alleged that she was threatened with criminal prosecution after her check bounced), 2001 WL 12166754; Good Morning America: Quick Cash Loan Outlets Cash Loan Warning (ABC television broadcast, Feb. 1, 1999) (reporting comments by Jean Ann Fox of the Consumer Federation of America in which she stated that many consumers report lenders threatening to throw them in jail), 1999 WL 10493218.

\textsuperscript{464} Drysdale & Keest, supra note 16, at 610.

\textsuperscript{465} Dean Foust et al., Easy Money: Subprime Lenders Make a Killing Catering to Poorer Americans, BUS. WK., Apr. 24, 2000 (stating that after a lender promised to give a woman a few more days to repay the loan, it deposited the check, which bounced, and then it sent the local sheriff to arrest her), 2000 WL 7825965; John Hendren, Exorbitant ‘Payday Loans’ Tide over the Desperate, Line Lenders’ Pockets, L.A. TIMES, Jan. 24, 1999, 1999 WL 2123661; see also Melissa Wahl, Payday Loans Can Force Workers into Deeper Debt, CHARLESTON GAZETTE & DAILY MAIL, May 21, 2000 (describing a Chicago working mother, who paid a payday lender almost $10,000 over two years and stated that she almost went to jail for defaulting on the loan), 2000 WL 2609149.

\textsuperscript{466} Ann Hayes Peterson, Payday Loans, CREDIT UNION MAG., Dec. 1, 2000 (telling the story of a woman who went to eight different payday lenders and incurred $2,400 in fees before she contacted a local television station’s consumer reporter), 2000 WL 11799761.

\textsuperscript{467} Drysdale & Keest, supra note 16, at 611 n.123. Problems with payday
In states where lenders know prosecutors do not seek convictions against payday borrowers, some lenders resort to underhanded tactics to intimidate consumers to repay loans. For example, in Ohio, a low-income housekeeper filed a complaint against First American Ca$h Advance alleging that, in addition to threatening her with criminal prosecution, the payday lender sent her a counterfeit complaint containing a phony date on which she supposedly had to appear in court.\footnote{Compl. at 4-5, Lille Evans v. Union Mgmt. Co., (Ohio Ct. Com. Pl. filed Oct. 24, 2000) (No. A0006694) (on file with author).} After losing peace of mind, a night of sleep, and a day of work, she appeared in court only to discover from the county clerk that the complaint had never been filed and the court date had been fabricated.\footnote{Id. at 5-6. Note that the county clerk advised Ms. Evans to hire a lawyer.} In Florida, a state regulator shut down one payday lender who was using counterfeit stationary from the Martin County Sheriff's Office to threaten defaulting customers.\footnote{Id. at 5-6.} In Illinois, Nationwide Budget Finance closed twenty-six stores after settling a lawsuit arising from a criminal prosecution threat contained in a postcard sent by Nationwide to a payday loan customer.\footnote{Scott Bernard Nelson, \textit{Group Assails Payday Lenders}, TAMPA TRIB., Nov. 11, 1998, 1998 WL 13784457.}

Normally, a consumer does not commit a crime when he or she defaults on a loan. Payday loan customers, however, may be subject to criminal prosecution because states criminalize lenders seeking to prosecute debtors were significant enough to move the Kentucky legislature to amend its payday loan statute to require that lenders post a notice informing customers that they are not subject to criminal prosecution. \textit{Id.} at 610-11. 

\footnote{Martha Neil, \textit{Payday Lender to End Operations Here}, CHI. DAILY L. BULL., Dec. 21, 1999, at 3 (reporting that Nationwide Budget Finance, a St. Louis-based payday loan company, settled the litigation for over $700,000); see also Earl Golz, "\textit{Payday Lenders} Sued over High Interest Rates," AUSTIN AM.-STATESMAN, May 13, 1999 (indicating that payday lender Cash Today threatens enlisting the help of local law enforcement to collect debts owed by customers), 1999 WL 7412336; Helen Huntley, \textit{Borrower Sues Area Payday Loan Firm}, ST. PETERSBURG TIMES (Fla.), Oct. 22, 1999 (describing a Chicago customer who filed a lawsuit against Florida-based All-State Pay Day Advance Inc., alleging that after she defaulted, the lender faxed her a letter stating that she would be prosecuted, and warning customers of possible penalties, including jail time and fines), 1999 WL 27323640; Steve Jordon, \textit{Nebraska "Payday Lenders" Lure Some Borrowers into Endless Cycle of Debt}, KNIGHT-RIDDER TRIB. BUS. NEWS, Apr. 11, 2000 (quoting Senator David Landis of Lincoln, Nebraska, as saying that he was informed of a payday lender who mailed copies of the bad-check criminal statute as part of its collection efforts), 2000 WL 19315278.}
the issuance of a check when the person's account has insufficient funds to cover the check. For instance, under Ohio law, "[n]o person, with purpose to defraud, shall issue . . . a check or other negotiable instrument, knowing that it will be dishonored." Ohio law presumes that a person knew his or her check would be dishonored if the person did not make payment within ten days after receiving notice that the check had been dishonored. A cursory reading of Ohio law and similar statutes from other states may lead one to believe that payday loan customers should simply plead guilty to the crime of writing bad checks. In the majority of jurisdictions, however, payday loan customers cannot be convicted for passing bad checks. In some states, lawmakers have statutorily excluded post-dated checks from the definition of the bad-check crime. In other states, judicial precedent holds that drawers cannot be convicted under bad-check criminal statutes if the payee took a postdated check with an understanding that the check was not then payable from drawer's bank account.

Even though bad-check laws in the majority of states favor payday loan customers, some lenders use the criminal justice system as its debt collection agency because prosecutors and judges either are unaware of judicial precedent or are unfamiliar with the mechanics of payday loans. This section analyzes Ohio bad-check law because the author was able to secure documents revealing that Ohioans who default on

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473. OHIO REV. CODE ANN. § 2913.11(A) (Anderson 1995).
474. Id. § 2913.11(B)(2). The presumption established under section 2913.11(B) is rebuttable. State v. Powers, No. 92 CA 10, 1993 WL 278456, at *3 (Ohio Ct. App. July 27, 1993).
475. See, e.g., 2002 Md. Laws ch. 26, § 2, WL MD LEGIS 26 (2002) (to be codified at MD. CODE ANN., CRIM. LAW § 8-101(b)) (amending article 27, section 140(a), of the Maryland Annotated Code of 1957, but still indicating that the bad-check statute applies only to a check "that is not postdated at the time it is issued"); Banderas v. State, 372 So. 2d 489, 490 (Fla. Dist. Ct. App. 1979) (upholding a state law that precluded criminal prosecution of postdated checks returned for insufficient funds).
476. See, e.g., 32 AM. JUR. 2D False Pretenses § 73 (1995) ("A postdated, worthless check relieves the drawer of responsibility, since the check implies on its face a present insufficiency of funds . . . ."); John Perovich, Annotation, Application of "Bad Check" Statute with Respect to Postdated Checks, 52 A.L.R.3d 464, 483-84 (1973) (summarizing state precedent, which holds that accepting a postdated check precludes application of bad-check laws).
payday loans have reason to fear prosecution. The Prosecutor's Division of the Columbus City Attorney's Office operates a check mediation program for debtors who have a complaint for passing a bad check filed against them. Some payday lenders in Columbus use this program. In the notification letter that the Prosecutor's Division sends to debtors, the following warning is provided to debtors participating in the program:

If there is no resolution and the complaint is deemed valid, a criminal charge of Passing Bad Check(s) may be filed. Once a criminal charge is filed it cannot be dropped, even if restitution is made. Passing bad check(s) is a crime under Columbus City Code Section 2313.11 and Ohio Revised Code Section 2913.11. A conviction to this charge could result in a maximum penalty of six months imprisonment and/or a $1000 fine.

The author suggested to the coordinator of the program that the letters sent to payday loan debtors should state that the debtor is not subject to criminal prosecution because intent to defraud is lacking. The coordinator stated that the prosecutor wanted the letters to be uniform irrespective of the facts. The prosecutor's notice letter to payday loan customers directly contradicts Ohio case law, which holds that no crime is committed when the payee knows that, at the time it takes the check, the funds in the debtor's account are insufficient to cover the check. Needless to say, the notice

477. See Memorandum from the Check Resolution Program, to All Staff and All Participating Agencies (Feb. 5, 2001) (on file with author).
478. Telephone Interview with Barbara A. Williams, Coordinator, Bad Check Program, Columbus City Attorney's Office (June 7, 2001).
479. Letter from Columbus City Attorney's Office to Potential Check Fraud Defendants (on file with author). Note the author invoked a state "sunshine" law to obtain a copy.
480. Telephone Interview, supra note 478.
481. See id.
482. Koenig v. State, 167 N.E. 385, 388 (Ohio 1929). In Koenig, the defendant testified that he had informed the bank employee that he did not currently have sufficient funds and asked the bank to hold the check for a few days so he would be able to deposit such funds. Id. The court held that if the accused advised the Farmers' Bank prior to the issuing of checks that he did not then have the funds on deposit, or credit arranged for that would cause the check to be paid on presentation, then manifestly the bank was not deceived by any misrepresentation, and the issuing of a check under such conditions would not be a procurement of the funds of the bank with an intent to defraud, as stated in the statute.
letter will breathe life into the words of those payday lenders who threaten criminal prosecution and cause payday loan customers who receive the notice letter to fear imprisonment and resort to any means to pay off the debts. In fact, the Ohio survey found one loan contract stating, “Borrower understands that the issuance of such check was a condition of Lender in making this loan; and that in the event such check is issued in violation of the [Ohio Revised Code] section 2913.11 (Passing Bad Checks), Borrower can be held criminally and civilly liable.”

Payday loan debtors in Ohio not only have the threat of prosecution from state prosecutors looming over their heads, but, in some counties, they are actually subject to bad-check prosecution. In Morrow County, payday lenders are registering criminal complaints against payday loan customers. As an example, consider the complaint registered by Checkloan with the Morrow County Prosecuting Attorney’s Office against Joshua Evans, who defaulted on a payday loan evidenced by a postdated check in the amount of $201.25. The state charged Mr. Evans with passing a bad check in violation of section 2913.11(A) of the Ohio Revised Code. At his initial appearance, Mr. Evans, who was not represented by counsel, pled no contest, and the judge entered a guilty finding against him. For his crime, Mr. Evans was sentenced to serve ten days in the county jail, and fined $250, in addition to court

Id. at 388. Even though a customer may not have explicitly informed a payday lender that there were not sufficient funds to cover her post-dated checks, knowledge or understanding by the payee that the drawer of the check has insufficient funds negates the intent to defraud. State v. Creachbaum, 263 N.E.2d 675, 679 (Ohio Ct. App. 1970), aff’d, 276 N.E.2d 240 (Ohio 1971). In Creachbaum, the defendant (drawer) was check kiting, “a scheme whereby false credit is obtained by the exchange and passing of worthless checks between two banks.” Id. at 678. At some point, the bank manager became aware of what the defendant was doing and realized that he really did not have sufficient funds in either account. Id. at 676. This realization led the court to hold that “it was within the knowledge of [the payee] that there were insufficient funds to cover the checks,” which “destroyed the intent to defraud.” Id. at 679-80. Therefore, express communication to the payee is not necessary as long as the facts and circumstances support an understanding or knowledge that there are insufficient funds. Id. at 679.

483. Checkland Payday Loan Contract (emphasis added) (on file with author).


486. Id.
costs and the $201.25 judgment against him. The judge suspended Mr. Evans's sentence on the condition that Mr. Evans perform four days of community service, pay $231.25, and have no similar law violations for twelve months. Prior to entering Mr. Evans's plea, the judge explained to Mr. Evans his rights. Tragically, Mr. Evans did not have a lawyer or a knowledgeable judge to inform him that Ohio precedent holds that intent to defraud is necessary and therefore a bad-check conviction is not sustainable if the payee took the check with knowledge that the debtor's bank account was insufficient to cover the check.

Fortunately for payday loan customers in other localities, some judges distinguish payday loan cases from typical bad-check fraud cases and, accordingly, will not treat payday loan debtors as criminals. In State v. Sparks, the state charged a payday loan customer with two counts of passing bad checks in violation of section 2913.11. The lender, Ohio Valley Check Cashing & Loan, required the customer to issue it two checks in order for her to borrow $500, with a fee of $75 (amounting to an APR 391%). Ohio Valley agreed not to cash the checks until November 17, 1998, but waited until February 8, 1999, to attempt to cash them. By then, the customer had closed her

487. Id.
488. Id.
489. Id.
490. Id.; see supra note 482 and accompanying text.
492. Id. at 1-2. The lender could have easily required the customer to issue one check in the amount of $500. The practice of requiring the customer to issue two checks has been criticized as an attempt by lenders to generate additional fees. In Bellizan v. Easy Money of Louisiana, Inc., a class of plaintiffs alleged that payday loan defendants required customers to issue one check on one date for part of the desired loan amount and then return a few days later and issue another check for the remaining amount so that defendant could exact a second set of fees. No. CIV.A.00-2949, 2001 WL 121909, at *2 (E.D. La. Feb. 12, 2001). This alleged practice sustained a cause of action under the statute that was in force at the time the loans were made, LA. REV. STAT. ANN. § 9:3577.6(A)(4) (West Supp. 1997) (repealed 1999), and a current statute, LA. REV. STAT. ANN. § 3578.6(A)(4) (West Supp. 2002), which provides that a "[s]mall loan licensee shall not . . . [d]ivide a deferred presentment transaction or small loan into multiple agreements for the purpose of obtaining a higher fee or charge." Bellizan, 2001 WL 121909, at *2, *5 (denying defendants' motion to dismiss plaintiffs' state law claims).
493. Sparks, 99 CRB 936-1-2 at 2.
Ohio Valley then sent the customer a certified letter notifying her that the checks had been dishonored and demanding that she repay or risk being referred to the prosecutor. She failed to make payment within ten days after the notice. The court noted that the statutory presumption regarding intent to defraud is triggered if the check is dishonored upon presentment within thirty days after it is issued or the stated date, whichever is later, and that the defendant customer failed to pay within ten days after receiving notice that her check had been dishonored. Relying on precedent, the court found the intent to defraud lacking because "Ohio Valley Check Cashing & Loan entered into a consumer loan agreement with the [d]efendant knowing full well that she did not have funds in her checking account at the time [it] loaned her $500." The court further explained that "these matters constitute, at most, a breach of contract upon which the victim is entitled to civil remedies."

Notably, the court in State v. Sparks suggested that Ohio Valley instructed the customer to write two checks instead of one so that a prosecutor who favored prosecuting payday loan customers could be assigned to bad check cases arising from payday loans:

Defendant was required to tender two checks for repayment of her loan rather than one. If she had tendered one check the amount would have exceeded $500.00 which would cause this matter to be returned to Washington County Prosecutor Michael Spahr for felony charges. By accepting two checks in an amount less than $500.00 these matters would be considered misdemeanors and referred to the Marietta City Law Director for prosecution. Apparently, Prosecuting Attorney Michael Spahr does not feel that this is a criminal offense and has refused to prosecute these cases.

The presence of counsel for the customer allowed her to thwart Ohio Valley's plot to obtain a conviction through the ignorance

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494. Id.
495. Id.
496. Id.
497. Id. at 3. The court rejected a presumption of intent based on the defendant's closing of her bank account because Ohio Valley did not present the checks to the bank until well after the thirty-day time limit. Id.
498. Id. at 4 (emphasis added).
499. Id. at 5.
500. Id. at 4.
of a few local attorneys and judges.\textsuperscript{501}

Rather than leaving the issue of criminal prosecution of payday loan customers to prosecutors and judges, several states ban bad-check prosecution outright\textsuperscript{502} while others allow it if a customer's check was dishonored because the customer closed his or her bank account and/or stopped payment on the check.\textsuperscript{503} As additional consumer protection, a few states require lenders to provide certain notices to the consumers. For example, in Kentucky, payday lenders must post in their stores a sign with the following words: “No person who enters into a post-dated check or deferred deposit check transaction with this business establishment will be prosecuted or convicted of writing cold checks or of theft by deception under the provisions of KRS 514.040.”\textsuperscript{504} A few states require the loan contract to contain a similar notice.\textsuperscript{505} States recognize the need of consumers to obtain unsecured short-term loans,\textsuperscript{506} but realize that consumers must have basic protections from those payday lenders who have discarded ethics and are driven by greed. Long ago, the United States progressively did away with debtors' prisons and adopted the policy that people should not be criminalized for failure to pay their debts.\textsuperscript{507} It decided

\textsuperscript{501} Compare id., with State v. Evans, 01-CRB-2097 (Ohio County Ct. Mar. 22, 2001) (no slip opinion, on file with author), and supra text accompanying notes 485-91.


\textsuperscript{503} See, e.g., Haw. Rev. Stat. § 480F-6(d) (Supp. 2001); N. D. Cent. Code § 13-08-12(8) (Supp. 2001) (establishing that a payday loan customer is subject to criminal prosecution if “the account on which the check was written was closed on the original date of the transaction”).


\textsuperscript{505} See e.g., Fla. Stat. Ann. § 560.404(20)(2) (West Supp. 2002) (requiring payday loan contracts to include the following: “YOU CANNOT BE PROSECUTED IN CRIMINAL COURT FOR A CHECK WRITTEN UNDER THIS AGREEMENT, BUT ALL LEGALLY AVAILABLE CIVIL MEANS TO ENFORCE THE DEBT MAY BE PURSUED AGAINST YOU.”); Mont. Code Ann. § 31-1-721(2)(d) (requiring the following statement immediately before the consumer's signature line: “you cannot be prosecuted in criminal court for collection of this loan”).


\textsuperscript{507} As one scholar observed, “Imprisonment for debt was commonplace in the colonies and then in the states, until the mid-nineteenth century.”
that imprisonment of debtors imposes great costs to society and prevents debtors from earning wages to repay their debts.\textsuperscript{508} In view of the foregoing, state lawmakers should act in accord with progressive thinking and enact laws that protect payday loan customers from bad-check prosecution. Payday lenders will then be on equal footing with other creditors who must resort to the civil court system to recover damages arising from a debtor's breach.\textsuperscript{509}

As long as payday lenders have the ability to use the criminal justice system as a collection agency, they possess a strong economic incentive to threaten customers with criminal prosecution. Payday loan customers will do whatever it takes to keep from going to jail; thus, payday lenders are assured of getting paid as long as consumers fear imprisonment.\textsuperscript{510}

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508. Gary Klein, \textit{Consumer Bankruptcy in the Balance: The National Bankruptcy Review Commission's Recommendations Tilt Toward Creditors}, 5 AM. BANKR. INST. L. REV. 293, 322 n.177 (1997) ("Debtor's prisons would do little to enhance creditor recoveries since it is hard to earn wages from prison and imprisonment would have enormous social costs."); Meeting of OAS-CIDIP-VI Drafting Committee on Secured Transactions Conference Transcript, Day One, 18 ARIZ. J. INT'L & COMP. L. 334, 389 (2001) ("[T]he debtor who is best able to repay a debt is not the one who is in prison but the one who is gainfully employed.").
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509. As the court stated in \textit{State v. Sparks}, a customer's inability to repay a payday loan would "constitute, at most, a breach of contract upon which the victim is entitled to civil remedies." 99 CRB 936-1-2, at *5 (Ohio Mun. Ct. Aug. 26, 1999) (no slip opinion, on file with author).
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510. At Christ the King Parish in Kansas City, church parishioners, "noticing a 50 percent increase in demand at [the church's] food pantry over the last four years, learned from interviewing emergency assistance clients that 80 percent of them owed money to a payday loan company." Kevin Kelly, \textit{Christ the King CCO Targets Payday Loan Industry}, \textit{The Catholic Key} (Kansas City), Mar. 3, 2001, http://www.catholickey.org/index.php3?archive =1&gif=news.gif&mode=view&issue=20010401/article_id=1306 (last visited Oct. 18, 2002). Within five blocks of the church are seven payday lenders and two banks. \textit{Id.} No doubt many of these consumers are paying rollover fees, instead of buying food, because some payday lenders in Missouri seek criminal prosecution of their customers. Bruce, supra note 462 (quoting senior counsel for Missouri's Division of Finance as stating that a few prosecutors bring bad-check charges against customers who default on payday loans). After hearing
Therefore, one can expect that in the absence of legislative measures passed to protect consumers, too many lenders will not follow the best practice of forbearing criminal prosecution. They stand to gain too much money to be guided by scruples.

In summary, consumers who take out payday loans may experience even greater financial stress and a litigative nightmare. As the Ohio Survey demonstrates, consumers seek out payday lenders because these lenders promise fast and easy cash, yet lenders disburse loan proceeds with proportional measures of duplicity and misinformation by evading loan disclosure requirements. Payday loan customers face rollovers that turn a two-week loan into a long-term financial obligation costing hundreds of dollars more than initially agreed. Other borrowers face punitive legal measures in the form of treble damage remedies and criminal prosecution. Payday lenders have managed to engage in egregious practices that one would expect to evoke the rejection and hostility of the free market, not to mention the wrath of democratically elected legislative bodies. Instead, the industry has experienced phenomenal growth. Clearly, payday lending presents a case where market imperfections compel government intervention. As a means of illuminating the type and manner of regulation needed, the next section explores why payday lending has managed to thrive and create the prevailing climate of consumer exploitation.

III. ECONOMIC REALITIES AND CURRENT LAW PERMIT CONSUMER EXPLOITATION

The previous sections of this Article highlight the significant consumer protection concerns arising with the growth of payday lending. As both the Ohio Survey conducted specifically for this article and the significant evidence collected from other jurisdictions amply demonstrate, predatory practices permeate the payday lending industry. Crafting confessions from parishioners, the late Monsignor John Egan, a Catholic priest in Chicago, was shocked to discover that many of them were hopelessly in debt after borrowing from payday lenders. Foust, supra note 465. He scraped together $720 to help one working mother with two dependents pay off two payday lenders. Id.  
511. See discussion supra Part II.A.2.  
512. See supra notes 274-92 and accompanying text.  
513. See discussion supra Part II.B.2.  
514. See supra notes 21, 55, 63.
effective regulation to resolve these consumer protection issues requires an understanding of the economic realities faced by typical payday loan customers. The demographic data presented in section A below suggest why the principles of freedom of contract and free enterprise fail to empower these consumers in any meaningful way. The data demonstrate why a largely unregulated free market has led to what is best characterized in the payday lending context as economic exploitation rather than efficiency. As the data suggest, sharply limited personal financial resources leave a large proportion of payday loan customers with few consumer credit options but, nonetheless, with a substantial and frequent need for short-term credit. Accordingly, they find themselves at the mercy of payday lenders. Presented with a captive customer base, payday lenders have had little trouble evading the regulation currently on the books. They have done so by exploiting a variety of legal loopholes and regulatory gaps, as described in section B.

A. DEMOGRAPHIC DATA ABOUT PAYDAY LOAN CUSTOMERS

Payday lenders market their loan product to cash-strapped consumers lacking access to traditional forms of credit. Discerning the correct image of the average payday loan customer depends on whether one finds persuasive self-reported information from payday lenders or demographic data from regulatory agencies and consumer advocates. According

515. Melissa Allison, Poorer Areas Also Poor in Bank Branches, CHI. TRIB., Nov. 25, 2001, § 5, at 1 (explaining that a shortage of banks creates few alternatives in poor neighborhoods forcing consumers to either pay higher rates at a check-cashing store to cash payroll checks even though a direct deposit option at a local bank is free or pay a higher interest rate on a loan with a payday lender even though a loan from the bank is available at a more reasonable rate), available at 2001 WL 30795327; Allison, supra note 30 ("[M]any minority and low-income neighborhoods have fewer bank branches than they have payday loan shops and currency exchanges, which typically cost less to operate and charge higher fees.").

516. Barbara A. Rehm, Payday Lenders Try Standard Approach to Respectability, AM. BANKER, Jan. 24, 2000, at 3 (stating that according to the CFSA's executive director, James Zaniello, payday lenders "stepped into a market that banks abandoned [given that] banks rarely make loans for less than $1000"), available at 2000 WL 3359121.

517. See also discussion supra Part I.B.2 (explaining the payday lending industry's use of "sham transactions" to avoid making TILA disclosures).

518. See infra notes 537-47 and accompanying text.
to the industry, the median annual income of a payday loan borrower is $35,000.\footnote{519} In a recent study funded in part by the payday loan industry,\footnote{520} Georgetown University professors, using data supplied by payday lenders, conducted telephone interviews of the customers and reported that 51.5\% have moderate incomes ranging from $25,000 to $49,999.\footnote{521} Compare this finding with a 2001 study by the Wisconsin Department of Financial Institutions that reported an average gross income of $24,673,\footnote{522} a 1999 study of data collected by the Illinois Department of Financial Institutions that found an average income of $25,131,\footnote{523} and a study by the California office of Consumers' Union that calculated an average annual income of $25,417.\footnote{524} In the six states where over half of the nation's payday lenders are located, the median incomes are below the national median, and in four of them, the poverty rates are above average.\footnote{525} Based on the foregoing, one may conclude that payday loan customers are primarily low-to-moderate income consumers who have personal checking accounts.\footnote{526} This group of consumers comprises America's largest and fastest growing income group.\footnote{527}

Although the Georgetown study asked questions about the gender and racial background of the customers,\footnote{528} the study

\footnote{519} Miller, \textit{supra} note 20, at 120.

\footnote{520} GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, CREDIT RESEARCH CTR., \textit{PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CUSTOMER DEMAND}, at iii (2001), at \url{http://www.msb.edu/prog/crc/order/Mono35.pdf} (last visited Aug. 28, 2002) (reporting the results of a study funded by the CFSA, the payday loan industry's national trade association). The authors of the Georgetown study admit that it is not "necessarily representative of all payday customers." \textit{Id.} at 19.

\footnote{521} \textit{Id.} at iv, 19, 28-29. Of the 2196 customers, only 427 completed telephone interviews and 726 (or 33.1\%) quit the interviews after denying using payday loans. \textit{Id.} at 21.

\footnote{522} \textit{REVIEW OF PAYDAY LENDING IN WISCONSIN, supra} note 291, at 5, \url{http://www.wdfi.org/_resources/indexed/site/newsroom/press/payday_loan_may_2001.pdf}.

\footnote{523} Keest, \textit{supra} note 44, at 1111 n.2 (indicating that the $25,131 salary is only 60\% of Illinois's median income).

\footnote{524} \textit{Id.}

\footnote{525} \textit{Id.} at 1112 (indicating that more than half of the nation's payday lenders are in Kentucky, Missouri, Mississippi, Tennessee, South Carolina, and North Carolina).

\footnote{526} Miller, \textit{supra} note 20, at 119.

\footnote{527} \textit{Id.}

\footnote{528} ELLIEHAUSEN & LAWRENCE, \textit{supra} note 520, at 84.
reports no data about the gender or racial makeup of the customers surveyed. Both the Wisconsin and Illinois studies found that the majority of payday loan customers were female. Lenders, in fact, target welfare recipients, the overwhelming majority of whom are women. The American Association of Retired People (AARP) analyzed locations of check-cashing outlets, over half of which offer payday loan services, and found that “low-income and minority households are significantly more likely to have [check-cashing outlets] located within one mile of their homes than higher-income and nonminority households.” A recent study on participants in the Illinois study found payday lending in areas with a high minority population while the Consumers’ Union’s study found the highest concentration of payday lenders near military bases in California. Both Illinois and Consumers’ Union discovered

529. *Id.* at 32-33 (stating that the majority have some college education).
530. *REVIEW OF PAYDAY LENDING IN WISCONSIN, supra* note 291, at 5 (indicating that 54% were female), http://www.wdfi.org/_resources/indexed/site/newsroom/press/paday_loan_may_2001.pdf; *Fox & Mierzwinski, supra* note 63, at 6 (indicating that 62% were female).
533. *Fox & Mierzwinski, supra* note 63, at 6 (“The zip code in California with the greatest number of payday lenders is 92054 which is directly south of Camp Pendleton Marine Base which has approximately 37,000 active duty personnel.”). America’s armed forces have a high percentage of minorities in comparison to the general population. Kif Augustine-Adams, *Gendered States: A Comparative Construction of Citizenship and Nation, 41 Va. J. Int’l L. 93, 112-13* (2000) (stating that “minorities of color are represented in the U.S. military at a greater percentage than in the U.S. population”). Consequently, minorities, although indirectly, are targeted by payday lenders. Additionally, payday lenders, as part of the subprime market, are more likely to exist in black neighborhoods. Carole B. Weatherford, Editorial, *Payday Lenders*
that payday lenders target people on fixed incomes. A business plan for one payday lender describes its customers as disproportionately minority, females who are the heads of household and who have dependent children, earn less than $25,000, and possess a high school diploma or less. Clearly, a comprehensive study about who uses payday loans would be helpful, but as will be discussed later, such a study is not necessary to conclude that the industry is in need of regulation.

Despite the dispute over the demographic makeup of payday loan customers, the Georgetown study contributes to the debate because it shows that the majority of such individuals believe, for logical reasons, that they do not qualify for traditional forms of credit. The Georgetown study revealed that 41.7% of the customers surveyed owned their homes, but Wisconsin and Illinois regulators found lower levels of home ownership (22% in Wisconsin and less than 32% in Illinois). Therefore, many could not get home equity loans to cover their financial crises. In comparison to 3.7% of the general population, the Georgetown study found that 15.4% of payday loan customers had previously filed for bankruptcy.


Unequal Burden: Income and Racial Disparities in Subprime Lending in America, a study by the U.S. Department of Housing and Urban Development, found that subprime loans are five times more likely in black neighborhoods than in white neighborhoods. In addition, homeowners in high-income black areas are twice as likely as homeowners in low-income white areas to have subprime loans.

Id.

534. Keest, supra note 44, at 1111 n.2.
535. Fox & Mierzwinski, supra note 63, at 6.
536. See infra notes 627-718 and accompanying text.
537. ELLIEHAUSEN & LAWRENCE, supra note 520, at 46. The industry emphasizes loan issuance speed as a major factor in the appeal of payday loans to consumers. CREDIT UNION NAT'L ASS'N STATE ISSUES SUBCOMM., COMPENDIUM OF STATE ISSUE PAPERS 17 (2000) [hereinafter COMPENDIUM OF STATE ISSUE PAPERS]. Professor John Caskey, a national expert on fringe banking issues, states that lack of access to traditional credit is the primary reason why most payday customers obtain payday loans. Id.

538. ELLIEHAUSEN & LAWRENCE, supra note 520, at 42.
539. REVIEW OF PAYDAY LENDING IN WISCONSIN, supra note 291, at 5 (indicating that 64% were renters and 22% were homeowners); Fox & Mierzwinski, supra note 63, at 6.
540. ELLIEHAUSEN & LAWRENCE, supra note 520, at 46. A 2000 report by the Credit Union National Association (CUNA) concludes that “credit union members make up 1/3 of payday lender users” and asserts a link between
A prior bankruptcy filing would negatively impact a consumer's credit scoring and ability to obtain traditional credit.\footnote{541} Furthermore, 23.4\% of the customers borrowed cash from a pawnshop by pawning personal property.\footnote{542} This subset, along with the rest of the payday loan customers, may not have owned a nonessential item of sufficient value to use as collateral.\footnote{543} Pawn brokers, typically, only lend a fraction of the value of the property to be borrowed against.\footnote{544} Over half of the 56.5\% of customers who possess a credit card, choose not to use them because, in the last year, they had exceeded the credit card limit.\footnote{545} Moreover, in comparison to 21.8\% of adults in the general population, traditional creditors refused or limited credit to 73\% of the payday loan customers in the last five years.\footnote{546} Thus, the data demonstrate a lack of access to traditional credit and provide a rational explanation as to why these consumers resort to using extremely high-interest loans.\footnote{547}

consumers' obtaining payday loans and the increasing number of consumer bankruptcies. COMPENDIUM OF STATE ISSUE PAPERS, supra note 537, at 19. CUNA is the nation's largest trade association for credit unions and "condemns the practice of predatory lending." \textit{Id.} at 34.


542. ELLIEHAUSEN & LAWRENCE, supra note 520, at 46.

543. The Georgetown study shows that 45.4\% of the customers' most recent payday loans were between $201 and $300 and 20.3\% most recently borrowed in excess of $300. \textit{Id.} at 48.


545. ELLIEHAUSEN & LAWRENCE, supra note 520, at v.

546. \textit{Id.} at 46. In comparison to 14.3\% of adults in the general population, 67.7\% of the payday loan customers considered applying for credit but decided against it because they thought they would be denied. \textit{Id.}

547. Their predicament indicates they are high-risk borrowers, but the risk should not lead one to conclude they deserve to be subject to the predatory lending practices described in this Article.
Besides lacking access to traditional credit, the majority (65.7%) of the payday loan customers in the Georgetown study needed a loan to take care of financial emergencies arising from unplanned expenses or from an income reduction. As for those who obtained loans to cover expected expenses, some may have needed loans because they do not earn living wages, that is, income sufficient to cover reasonable expenditures for daily living. In summary, although the image of the typical payday loan customer remains incomplete, one should at least envision a consumer drawn to the payday loan industry because she lacks money to pay for financial emergencies, suffers from a recent income reduction (e.g., work hours reduced), earns nonliving wages, or a combination thereof, and because she lacks access to a moderately priced alternative form of credit. Few choices remain, then, for these consumers, but to turn to payday loan providers. Recognizing the profit potential of a customer base with an overwhelming need but few options, the payday lending industry has demonstrated remarkable ingenuity in navigating or evading state usury laws to fully exploit the financial vulnerability of their borrowers.

B. PACKAGING PAYDAY LOANS TO TAKE ADVANTAGE OF GAPS IN APPLICABLE LAW

In some jurisdictions, payday lenders, instead of disguising

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548. Elliehausen & Lawrence, supra note 520, at 47. In the study, a planned expense such as rent is classified as a discretionary expense item. Id. at 47 n.38. The authors assumed that consumers choose to spend their income rather than saving sufficient funds to pay for planned expenses. Id. With this simplified assumption, the authors overlooked the fact that many Americans simply do not earn living wages.

549. CMTY. REINVESTMENT ASS’N. OF N.C., CTR. FOR CMTY. CAPITALISM, TOO MUCH MONTH AT THE END OF THE PAYCHECK: PAYDAY LENDING IN NORTH CAROLINA 25 (Marcy Lowe ed., 2001), at http://www.kenaninstitute.unc.edu/Centers/CCC/paycheck.pdf (last visited Aug. 25, 2002); COMPRENDIUM OF STATE ISSUE PAPERS, supra note 537, at 17 (indicating that “90% of payday borrowers are ‘financially pressed’—have heavy debt or payment obligations”); Miller, supra note 20, at 119 (quoting U.S. Census data for July 1999 as finding that forty-nine million Americans “had difficulty making payments for basic needs”); Consumer Finance: Pay Dirt, ECONOMIST, June 5, 1999, at 28 (indicating that “[a] recent consumer survey found that 55% of Americans occasionally lack the funds to pay all their bills”), available at 1999 WL 7363382.

550. See discussion infra Part III.B.
the payday transactions to evade usury law, rely on omissions in statutory provisions to charge triple-digit interest rates in excess of usury limits.551 Unlike the previous group of lenders, these payday lenders admit that they are issuing loans but assert that some statutory language allows them to charge interest rates in excess of the law of the state where the customer resides.552 This practice exposes the payday lender as a predator: the greater interest rate is not being sought because the customer poses a great risk, but because legal loopholes afford the lender an opportunity to maximize its profits through crafty lawyering. The next section discusses two examples of the use of loopholes, one under state law, the Indiana Uniform Consumer Credit Code, and one under federal law, the National Bank Act.

1. Exploiting Ambiguities in State Law

In Livingston v. Fast Cash USA, Inc.,553 several payday lenders, relying on Indiana Uniform Consumer Credit Code section 24-4.5-3-508(7), claimed that they could charge up to $33 on a $200 loan.554 The plaintiffs, a putative class of borrowers, pointed out that the APR of 402% on this loan exceeded the maximum APR of 36% set forth in section 24-4.5-3-508(2), another subsection of the same code provision.555 The court rejected the defendants' contention that the subsection allowing the $33 finance charge was an exception to the subsection setting the maximum interest rate at 36% per year for small loans.556 The court noted that absent the allowance of a $33 charge under section 24-4.5-3-508(7), a $200 two-week loan would generate a small interest payment of only $2.77.557 After analyzing several code provisions and the legislative history the court ruled in favor of the plaintiffs:

To interpret the statute as Lenders suggest—allowing a minimum

551. See infra notes 554-612 and accompanying text (discussing the practices of payday lenders in Indiana and other states).
552. See discussion infra Part III.B.2 (discussing the practices of payday lenders in partnership with traditional banks).
553. 753 N.E.2d 572 (Ind. 2001).
554. See id. at 574-75 (citing IND. CODE § 24-4.5-3-508(7) (1996)).
555. See id.
556. See id. at 575 (citing Indiana Code, section 24-4.5-3-508(2), which caps APRs on loans of $300 or less at 36%).
557. See id. at 576-77.
finance charge of $33 for a loan that otherwise would generate what amounts to pennies in interest—is inconsistent with the purposes and policies of the IUCCC and creates an absurd result which the legislature could not have intended when the statute was enacted or when the various amendments were adopted.\

Therefore, in Fast Cash, the court held that the maximum 36% APR allowed for loans of $300 or less limits payday loan APRs and that the lenders were also limited by the provisions of an Indiana statute prohibiting loansharking—loans with APRs exceeding 72%.

2. Rent-A-Bank: Evasive Partnerships with Traditional Banks

The Fast Cash case represents a victory for consumer advocates and consumers living in Indiana, but the victory is a temporary one due to the recent practice of “rent-a-bank.” Leticia Ortega’s case shows how rent-a-bank practices affect consumers. Introduced at the beginning of this Article, Ortega is the Texas resident who paid National Money Service $1800 in interest charges on a $300 payday loan. In defending against a lawsuit filed by her, National Money Service claimed that, due to its partnership with a Delaware bank, Delaware rather than Texas law applied, thus exempting the loan from Texas’s usury law. Under Delaware law, the fees paid by Ortega were legitimate interest charges. Rent-a-bank or charter renting is an arrangement between payday lenders and national banks or federally insured depositories (collectively, hereinafter “banks”) located in states with no

558. See id. at 577.
559. See id. Indiana law defines loansharking as follows:

A person who, in exchange for the loan of any property, knowingly or intentionally receives or contracts to receive from another person any consideration, at a rate greater than two (2) times the rate specified in IC § 24-4.5-3-508(2)(a)(i), commits loansharking, a Class D felony.


560. See infra notes 565-67 and accompanying text.
561. See supra notes 1-10 and accompanying text (describing Ortega’s experience with National Money Service).
562. See Geller, supra note 2.
563. See id. (discussing the practices of payday lenders in partnership with traditional banks).
564. See id.; see also SKILLERN, supra note 304 (discussing the ability of payday lenders to charge higher fees than state laws would otherwise permit by using local agents).
usury limits for consumer loans. In theory, the banks underwrite the loans, while the payday lenders act as loan originators and collection agents. Profits made on the deals are shared between the banks and the payday lenders, similar to an average brokered loan transaction. Some doubt exists as to whether the banks are the actual lenders partly because many payday lenders immediately repurchase the loans. Rent-a-bank is the latest and most promising subterfuge used by payday lenders nationwide to avoid state usury limits. Black's Law Dictionary defines subterfuge as a "clever plan or idea used to escape, avoid, or conceal something." This section advances the proposition that payday lenders are engaged in subterfuge to the extent that they have the primary economic interest and role in the partnership arrangements with traditional banks but claim to be the "agents" of the banks. A court should rule that the preemption doctrine affords no protection to payday lenders having the primary economic interest in rent-a-bank partnerships.


566. Schaaf, supra note 268, at 357; see NORTH CAROLINA PAYDAY LENDING REPORT, supra note 290, at 6 tbl.III(F) (displaying data regarding customer usage of rent-a-banks), http://www.banking.state.nc.us/reports/ccfinal.pdf (last visited Sept. 20, 2002).

567. Schaaf, supra note 268, at 357.

568. See Chris O'Mallery, Indiana Payday Lenders Adjust to State Court Ruling, KNIGHT-RIDDER TRIB. BUS. NEWS, Aug. 21, 2001 (indicating that the director of the Indiana Department of Financial Institutions questions the true nature of the arrangement between banks and payday lenders), 2001 WL 26626647. Professor Gary Peller recently filed a class-action complaint against ACE, the largest payday lender in the United States, alleging that, in its brokerage arrangement with Goleta National Bank, ACE is the actual lender, not the broker, and therefore subject to Maryland usury law. E-mail from Gary Peller, Professor of Law, Georgetown University Law Center, to Creola Johnson, Assistant Professor of Law, The Ohio State University Moritz College of Law (Aug. 28, 2002, 11:16:00 EST) (on file with author).

569. Geller, supra note 2.

570. See Fox & Mierzwinski, supra note 63, at 14-23 (discussing the growing number of rent-a-bank partnerships).

571. BLACK'S LAW DICTIONARY 1444 (7th ed. 1999).

572. See discussion infra Part III.B.2.b.
partnerships.

a. **Scope of Preemption of State Law Under the National Bank Act**

The alleged legality of the practice of charter renting depends upon a provision in the National Bank Act that authorizes the creation of national banks\(^{573}\) and establishes their powers.\(^{574}\) Under section 85 of the National Bank Act, a nationally chartered bank “may take, receive, reserve, and charge, on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State ... where the bank is located.”\(^{575}\) To decide whether a federal law preempts state law, the Supreme Court of the United States first determines whether Congress has included an express provision for preemption in the relevant federal law or has evinced an intent that federal law “occupy the field.”\(^{576}\) In the absence of an express preemption provision or an occupation of the field, the Court finds preemption of the state law to the extent it conflicts with a federal statute.\(^{577}\) The National Bank Act does not include an express preemption provision or evince congressional intent to occupy the field of banking law; consequently, the “[Supreme] Court has often pointed out that national banks are subject to state laws, unless those laws infringe the national banking laws or impose an undue burden on the performance of the banks' functions.”\(^{578}\)

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575. Id. § 85.


577. Id.

578. Anderson Nat'l Bank v. Luckett, 321 U.S. 233, 248 (1944); see also Alan S. Kaplinsky, Exportation Litigation: Analysis and Implications of United States Supreme Court Opinion on Smiley v. Citibank (South Dakota), N.A., in CONSUMER FINANCIAL SERVICES LITIGATION 1997, at 313, 334 (PLI Corporate Law & Practice Course, Handbook Series No. 989, 1997) (citing Davis v. Elmira Sav. Bank, 161 U.S. 275, 287 (1896) and McClellan v. Chipman, 164 U.S. 347, 360-61 (1896)). The Office of the Comptroller of Currency, which is responsible for chartering, regulating, and supervising national banks, is in accord with the Supreme Court: “It is obvious that Congress has not occupied the field of banking so as to preclude state
In *Marquette National Bank v. First of Omaha Service Corp.*, the United States Supreme Court addressed whether the preemption doctrine would permit The First National Bank of Omaha (Omaha Bank), a national bank chartered in Nebraska, to charge its credit card customers in Minnesota an interest rate that was allowed under Nebraska law but that exceeded the rate allowed by Minnesota’s usury law. A wholly owned subsidiary of Omaha Bank solicited customers in Minnesota for Omaha Bank’s credit card program. As stated previously, section 85 authorizes a national bank to “charge on any loan” interest at the rate allowed by the laws of the state “where the bank is located.” Under the plain language of section 85, the Court held that a national bank could charge the rate of interest allowed by the state in which it was located and that Omaha Bank’s extension of credit to residents of another state did not change the bank’s location. After reviewing the legislative history and historical context of the Act, the Court found that section 85 was intended not merely to place national and state banks on an equal footing, but to give national banks advantages over their state competitors.


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580. Id. at 302.
582. See *Marquette*, 439 U.S. at 313 ("Since Omaha Bank and its BankAmericard program are 'located' in Nebraska, the plain language of section 85 provides that the bank may charge 'on any loan' the rate 'allowed' by the State of Nebraska."). This is also known as the “Most Favored Lender Doctrine.” See White, *supra* note 565, at 464-65 (providing a full explanation of the doctrine and stating that the doctrine also means that where “the bank comes from a state like Delaware whose laws permit consumer loans without rate or other restrictions, the out-of-state bank can ignore not only the local rates, but also the local market segmentation”); see also *STATE OF N.M.*, *HOUSE MEMORIAL 36 STUDY COMMITTEE RESOURCES AND MATERIALS* 10 (2000), at http://www.rld.state.nm.us/fid/news/hm36part2.pdf (last visited Sept. 2, 2002).
583. See *Marquette*, 439 U.S. at 312 ("The mere fact that Omaha Bank has enrolled Minnesota residents, merchants, and banks in its BankAmericard program thus does not suffice to 'locate' that bank in Minnesota for purposes of 12 U.S.C. § 85.").
584. See *id.* at 314.
state usury laws, "were at an almost insuperable competitive disadvantage."\textsuperscript{585} Two years after \textit{Marquette}, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA)\textsuperscript{586} "to prevent discrimination against State-chartered insured depository institutions."\textsuperscript{587} Section 521 of DIDMCA contains language nearly identical to that found in section 85\textsuperscript{588} and expressly preempts any state constitution or statute that inhibits a state-chartered bank's ability to charge the highest interest rate allowed by law in the state where the lender is located.\textsuperscript{589} By incorporating section 85 in DIDMCA, Congress established "competitive equality . . . between national banks and State[-]chartered depository institutions on lending limits."\textsuperscript{590} Consequently, like a national bank, a state-chartered lending institution may "use the favorable interest laws of its home state in certain transactions with out-of-state

\textsuperscript{585.} Greenwood Trust Co. v. Massachusetts, 971 F.2d 818, 826 (1st Cir. 1992).
\textsuperscript{586.} Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified in scattered sections of Title 12 and Title 15 of the United States Code); see Greenwood Trust, 971 F.2d at 826.
\textsuperscript{587.} 12 U.S.C. § 1831d(a) (2000) ("Congress tried to level the playing field between federally chartered and state-chartered banks when it enacted DIDMCA.").
\textsuperscript{588.} See Greenwood Trust, 971 F.2d at 827 ("Congress made a conscious choice to incorporate the [National] Bank Act standard into [DIDMCA].").
\textsuperscript{589.} See 12 U.S.C. § 1831d(a). Section 521 of the DIDMCA provides, in pertinent part, In order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater.
\textit{Id.}
\textsuperscript{590.} Greenwood Trust, 971 F.2d at 826 (quoting 126 CONG. REC. 6,900 (1980) (statement of Sen. Proxmire) (alteration in original)).
borrowers.\textsuperscript{591}

b. \textit{Federal Banking Law Protects Only Banks Qua Banks}

Just because the National Bank Act\textsuperscript{592} and DIDMCA\textsuperscript{593} clearly state that a nationally- or state-chartered bank may export the favorable interest rates of its home state does not mean that its purported agent may use banking law to circumvent state usury law.\textsuperscript{594} In recently decided cases involving ACE and Goleta National Bank, the majority of courts have sided with state regulators and have held that the National Bank Act does not preempt state law claims filed against ACE alone.\textsuperscript{595}

ACE, based in Irving, Texas, is America's largest check-cashing company\textsuperscript{596} and is the target of litigation in several states.\textsuperscript{597} After partnering with Goleta, ACE dropped some of its state lending licenses and claimed the ability to charge fees in excess of state laws.\textsuperscript{598} For example, the Ohio Department of Commerce's Division of Financial Institutions (Ohio DFI), served on ACE a Notice of Intent to Issue Cease and Desist Order, alleging that ACE, as the actual lender under its contract with Goleta National Bank, violated Ohio's payday

\begin{footnotesize}
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\item \textsuperscript{591} Id. at 827.
\item \textsuperscript{592} 12 U.S.C. § 85.
\item \textsuperscript{593} Id. § 1831d(a).
\item \textsuperscript{594} See infra notes 605-08 and accompanying text.
\item \textsuperscript{596} Teresa Dixon Murray, \textit{Payday Lender Wants No Limits: Texas-Based Firm Sues to Operate Without License in Ohio}, PLAIN DEALER (Cleveland), Nov. 15, 2001, 2001 WL 20555829.
\item \textsuperscript{597} Fox & Mierzwinski, \textit{supra} note 63, at 18-19.
\item \textsuperscript{598} \textit{Colorado Challenges "Rent-A-Bank,"} BANK NEWS, Aug. 1, 2001, at 40, 40-41, available at 2001 WL 12616184. Prior to Colorado's lawsuit, "ACE was warned against acting as an unlicensed supervised lender and was ordered to cease and desist from such lending and to refund to consumers all excessive and improper finance and other charges collected in renewing the loans more than once and assessing fees in violation of Colorado law." \textit{Id.}
\end{itemize}
\end{footnotesize}
to this notice, ACE was charging fees as much as 50% above the maximum rate allowed by Ohio law. Evidently, ACE was not content with its profit margin in Ohio even though the legalized effective APR for payday loans in Ohio is 391%. Although Goleta was not a party to the cease-and-desist action, Goleta filed an action in federal court against the Ohio DFI, alleging that, because Ohio's law interferes with Goleta's right to lend under conditions authorized by the National Bank Act, the Act preempts the Ohio DFI's authority to take administrative action against ACE.

599. Notice of Intent to Issue Cease and Desist Order, Notice of Opportunity for Hr'g, In re ACE Cash Express, Inc., (Ohio Dep't of Commerce, Div. of Fin. Insts. July 16, 2001) (No. 01-SL-01) (on file with author). The Ohio Department of Commerce determined that ACE was the actual lender under its contract with Goleta because of the following:

The Agreement requires [ACE] to: (i) purchase a [95%] participation in each and every loan made by the bank; (ii) bear [95%] of the loss on a defaulted loan; (iii) receive the loan payments; (iv) pay the expenses related to the collection or enforcement of a defaulted loan; and (v) keep the loan records.

Id. at 1. National advertisements also indicate that, in at least some brokerage arrangements between payday lenders and national banks, the interest rates charged for payday loans are not protected by the National Bank Act because payday lenders have a preponderant economic interest. A payday lender's advertisement in a recent issue of the American Banker stated,

LOOKING FOR A BANK
TO PARTNER WITH, TO BE A LENDER IN
THE PAYDAY LOAN BUSINESS.
Instant, Large Client Base
Strong Fee-Based Income
Minimal Financial Commitment

Classified Resource Directory, AM. BANKER, Mar. 27, 2001, at 17. Of course, one would need to look at the details of the contract between the payday lender and the bank, but this advertisement—especially the words "minimal financial commitment"—suggests that the payday company will have the preponderant role in this lending partnership.

600. Murray, supra note 596 (indicating that ACE is accused of charging 442% interest); Mike Pramik, Payday Lenders Bypass Laws, Group Charges, COLUMBUS DISPATCH, Nov. 14, 2001 (indicating that ACE has charged an interest rate 13% greater than allowed by Ohio law), 2001 WL 29755196.

601. In Ohio, lenders may charge interest at a rate of 5% per month plus an origination fee of $5 per $50 lent; these fees equal $7.50 per $50. OHIO REV. CODE ANN. §§ 1315.39-40 (Anderson 2002). As a result of these fees, the effective APR is 391% on a two-week loan.

602. Compl., Goleta Nat'l Bank v. O'Donnell, (S.D. Ohio filed Oct. 9, 2001) (No. C2-01-971). The Ohio litigation is still pending. The Ohio DFI is trying to persuade the district court to follow the majority of courts, which have held
ACE raised the same argument in response to a complaint filed in a Colorado state court against ACE alone by Colorado's Attorney General on behalf of the state.\(^{603}\) Subsequently, ACE removed the case to federal court.\(^{604}\) In addition to claiming that the National Bank Act protected the initial loan fee, ACE claimed that it could ignore Colorado's one-rollover limitation because its rollover fees, like the original loan fees, constituted interest and are therefore protected by the National Bank Act.\(^{605}\)

In deciding whether ACE could legitimately seek refuge under the National Bank Act, the district court found that ACE was not protected by the federal preemption argument based on its purported agency relationship with Goleta.\(^{606}\) Citing the Supreme Court's decision in *Marquette*, ACE argued that, like the wholly owned subsidiary in *Marquette*, it was entitled to the protection under the National Bank Act.\(^{607}\) The district court responded,

To the contrary, in this case [ACE] and the national bank are *separate* entities and their relationship does not give rise to complete preemption under the [National Bank Act]. I agree with Plaintiffs' argument that [ACE] "confuses what this case is and is not about. The Complaint *strictly* is about a non-bank's violations of state law. It alleges no claims against a *national bank* under the [National Bank Act]." My careful review of the Complaint indicates no allegations directed at Goleta or a national bank. Plaintiffs cite nine district court cases supporting their argument that the [National Bank Act] does not provide federal question removal jurisdiction in actions against entities which are not banks. I find the reasoning of these cases persuasive and conclude that [ACE]'s relationship with Goleta does not elevate [ACE]'s status to that of a national bank.\(^{608}\)

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that claims against ACE are not preempted by federal banking law. See, e.g., Def.'s Notice of Supplemental Authority, Goleta Nat'l Bank v. O'Donnell, (S.D. Ohio filed May 28, 2002) (No. C2-01-971) (providing the court with a copy of a North Carolina opinion rendered against Goleta); Def.'s Notice of Supplemental Authority, Goleta, (S.D. Ohio filed Feb. 6, 2002) (No. C2-01-971) (providing the court with a copy of a Colorado opinion rendered against Goleta); Def.'s Mot. To Dismiss, Goleta, (S.D. Ohio filed Nov. 23, 2001) (No. C2-01-971) (providing the court with copies of Florida and Maryland opinions rendered against Goleta).


\(^{604}\) Id.

\(^{605}\) Id. at 1284. ACE claimed that its “renewals [or rollovers] were made in partnership with Goleta National Bank of California and that they were permitted by the National Bank Act." *OCC Weighs In*, supra note 341.

\(^{606}\) *Salazar*, 188 F. Supp. 2d at 1284.

\(^{607}\) Id.

\(^{608}\) Id. at 1285 (citations omitted). The court also granted Colorado's
As a result, the court granted Colorado’s motion to remand the case to state court. Likewise, in a removal action filed by ACE, a district court in North Carolina ruled that ACE could not rely on the National Bank Act to preempt state law claims asserted against ACE alone.

Only one court has ruled in favor of ACE. In Hudson v. Ace Cash Express, Inc., a payday loan customer filed various claims, including a state usury claim, against ACE and Goleta in federal court. The court held that the usury claim was preempted by the National Bank Act and dismissed the case. The Indiana Department of Financial Institutions (Indiana DFI) was neither consulted nor involved in the Hudson litigation. Because of the long standing precedent that national banks can export their home-state interest rates under the National Bank Act, the Indiana DFI, had it been consulted, would have advised against naming Goleta as a defendant and against filing the complaint in federal court.

The Indiana DFI contends that if Hudson had filed the complaint against ACE alone, the district court would likely have ruled in favor of Hudson because “[t]he opinion does not establish in any way that ACE is entitled to the same preemptive effect where the bank itself is not a party to the case.” Others have criticized Hudson for refusing to look beyond the form of the loan documents and for allowing the plaintiff to proceed against ACE alone.

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609. Id. at 1287.
612. Id. at *1.
613. Id. at *5-6.
615. Id.
616. Id.
617. E-mail from Jean Ann Fox, Director of Consumer Protection, Consumer Federation of America, to Creola Johnson, Assistant Professor of Law, The Ohio State University Moritz College of Law (June 4, 2002, 12:06:00 EST) (stating that the “Hudson court refused to look at the substance of the
The Office of the Comptroller of Currency (OCC), the federal agency responsible for chartering and regulating national banks, has taken the position that ACE is not entitled to preemption. In the Colorado lawsuit, the OCC filed a motion for leave to file an amicus brief, which stated,

The standard for finding complete preemption is not met in this case. While the Defendants Notice of Removal repeatedly refers to Goleta National Bank using Ace Cash Express, Inc. ("ACE") as its agent to solicit loans . . ., ACE is the only defendant in this action, and ACE is not a national bank. Nor do the [attorney general's] claims against ACE arise under the National Bank Act, or other federal law. Although Defendant [ACE] apparently attempts to appropriate attributes of the legal status of a national bank for its own operations as a defense to certain of [the attorney general's] claims, such a hypothetical conflict between federal and state law does not give this court federal question jurisdiction under the doctrine of complete preemption.

Thus, the OCC and the majority of district courts concur that ACE is not protected under the National Bank Act simply because it claims to be an agent of a national bank.

The OCC's recent action against a bank demonstrates that it will not shy away from exerting its regulatory powers to stop a bank from partnering with payday loan companies that have the preponderant economic interest. Citing the following reasons, the OCC entered into a consent decree that orders Eagle National Bank to cease issuing payday loans through Dollar Financial:

The Bank had risked its financial viability by concentrating in one line of business—payday lending;

The Bank relinquished supervision of the program to a single third party originator of payday loans; and

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620. Id. (emphasis added).
621. See supra note 595. State courts must now decide the merits of the claims against ACE. However, the rights of national banks to charge home-state interest rates to payday loan customers in other states will not be affected by the state court rulings. See Goleta Nat'l Bank v. Lingerfelt, 211 F. Supp. 2d 711, 719 (E.D.N.C. 2002) ("Goleta is not a party to the state action. Accordingly, its rights to make loans to North Carolina residents and charge California interest rates will not be adjudicated, and the disposition of any issues touching upon those rights will not be binding upon Goleta in future actions.").
The payday lending program was conducted on an unsafe and unsound basis, in violation of a multitude of standards of safe and sound banking, compliance requirements, and OCC guidance.623

Like Eagle National Bank, a growing number of banks are abandoning their traditional lending responsibilities to companies that offer payday loans.624 While the OCC actions are commendable, it should not have to devote enormous time and resources to investigate these banks one-by-one. Congress needs to amend banking laws to prohibit rent-a-bank.

Thus far, the discussion has focused on sham transactions or subterfuge employed by payday lenders in the making of loans in order to circumvent federal and state laws, particularly usury laws. Their conduct ranges from claiming to sell services or products to partnering with banks while retaining the primary economic interest. Because section 85 only preempts a conflicting state usury statute, payday loans are therefore subject to credit disclosure requirements such as TILA,625 irrespective of whether the payday lender is acting alone or in concert with a bank. Clearly, when the payday lender is acting alone, its payday loans are subject to state usury limits. Even if the payday lender is acting in concert with a bank, the National Bank Act only preempts civil usury statutes to the extent that the payday loans are being offered by banks qua banks.626

As more fully explained in Part IV, federal legislation amending the National Bank Act should be passed to prohibit rent-a-bank because, inter alia, lenders charge interest rates greater than existing state payday lending statutes that authorize triple-digit interest rates and lenders violate rollover statutes enacted to protect consumers from perpetual indebtedness. Part IV further advocates for and describes a comprehensive system of payday lending regulations for enactment at the federal level. As Part IV demonstrates, a continued state-based approach to payday lending abuses will

623. Id.
624. See Fox & Mierzwinski, supra note 63, at 19-20.
625. See discussion supra Part I.B.2 (discussing payday lenders' attempts to avoid compliance with TILA).
not sufficiently protect consumers—it is time for the federal government to act.

IV. PROPOSED FEDERAL REGULATION

As discussed in depth in previous sections of this Article, the Ohio Survey and other reports show that payday lenders across the country make no assessment of a customer's ability to repay loans, demand fees that amount to triple-digit interest rates for payday loans, charge fees that exceed usury and payday loan statutes, give customers false or misleading information about the cost of credit, disguise payday loan transactions to evade state and federal law, refuse to supply customers with written disclosures prior to contract consummation, partner with banks to circumvent state-imposed interest-rate limitations, lead customers to believe that they can rescind loans at no cost, trap customers in a cycle of indebtedness through the practice of rolling over payday loans, seek improper treble damages in collection actions against customers, and pursue criminal prosecution of customers where no criminal culpability properly lies. The response of state lawmakers to these practices varies greatly. As explained below, due to the lack of competition among payday lenders and due to the industry's intentional distortion of consumer credit information, economic theory suggests that federal and state lawmakers need to act to regulate the industry. Moreover, federal regulation of the payday loan industry represents the best way to provide consumers with a base level of protection and to prevent payday lenders from using rent-a-bank and other practices to evade the laws in states that have attempted to provide consumer protection. For federal legislation to be effective, it should, at a minimum, do the following: cap fees for payday loans, prohibit rent-a-bank, prohibit rollovers, prohibit criminal prosecution, and require certain notices in the contract.

Section A establishes how sound economic principles justify federal regulation to accomplish these purposes. Section B demonstrates that although states have begun addressing

627. See discussion supra Parts I.B, II, and III.B.
628. See infra notes 690-716 and accompanying text.
629. See infra notes 631-62 and accompanying text.
630. See infra notes 663-18 and accompanying text.
the payday loan problem to some extent, regulations at the state level will likely continue to be, at best, a largely ineffective patch-work approach. Finally, section C describes the bare minimum protections federal law should afford payday loan borrowers.

A. ECONOMIC THEORY JUSTIFIES REGULATION OF THE PAYDAY LOAN INDUSTRY

Economic theory provides a justification for regulation of the payday loan industry because the industry lacks competition. In the Ohio Survey, research assistants obtained payday loans at one store location of each lender located in Franklin County.\(^\text{631}\) Franklin County had twenty-two lenders with eighty-three store locations at the time of the survey.\(^\text{632}\) All twenty-two payday lenders surveyed charged the maximum fee allowed on a $50 or $100 loan.\(^\text{633}\) Other reports indicate that, despite the industry's rapid growth, the prices charged by the majority of lenders are at maximum legal rates or higher.\(^\text{634}\) In the Ohio Survey, a few lenders offered discounts or coupons but most were available only to repeat customers.\(^\text{635}\) No one accuses the lenders of being in collusion; yet, payday lending has been legal in Ohio since 1996,\(^\text{636}\) and the industry's finance charges have not decreased despite the passage of time and an increase in the number of lenders. Based on the foregoing, a market failure appears to exist in the payday loan industry due

\(^{631}\) See supra notes 158-63 and accompanying text (explaining the author's methodology).


\(^{633}\) See infra App., tbl.2.

\(^{634}\) See Hoopes, supra note 271, at 8 (indicating that 53% of the payday lenders surveyed in a Colorado survey charged the highest allowable fee of $20 per $100, resulting in an APR of 520%); Fox & Mierzwinski, supra note 63, at 11-12 (indicating that 15% of the payday lenders surveyed in the twenty-six states that authorized payday lending quoted rates higher than allowed by law, and 38% quoted rates at the highest allowable fee).

\(^{635}\) See supra note 167 (explaining that surveyors were not wired with any audio or video recording equipment, and, therefore, no direct evidence exists that these statements were made).

to the lack of competition regarding price. Such a failure may therefore justify regulation of the industry.\textsuperscript{637}

While lack of competition alone may not justify regulatory action, the industry's distortion of pertinent information clearly provides justification because it prevents consumers from freely making informed choices about obtaining payday loans.\textsuperscript{638} Payday lenders contend that they provide a service to people who otherwise could not qualify for short-term, unsecured loans, and therefore any proposed regulation of the industry should give way to the consumer's freedom of choice.\textsuperscript{639} Freedom of contract rests at the foundation of contract law and is premised upon the notion that parties should be able to negotiate the terms of their bargain.\textsuperscript{640} Contracting parties may

\begin{itemize}
\item \textsuperscript{637} See Andre Hampton, Markets, Myths, and a Man on the Moon: Aiding and Abetting America's Flight from Health Insurance, 52 Rutgers L. Rev. 987, 989-90 (2000) (arguing that a lack of governmental regulation exacerbates the externalities, or the benefits and costs imposed on society that a private actor does not need to take into account). But see Ted Schneyer, Legal-Process Constraints on the Regulation of Lawyers' Contingent Fee Contracts, 47 DePaul L. Rev. 371, 373 (1998) (arguing that "[r]egulatory intervention is not justified in every instance in which consumer ignorance, third-party effects, or lack of competition produce market imperfections").
\item \textsuperscript{638} See discussion supra Part II.A.2 (analyzing payday lenders' failure to provide disclosures required by law).
\item \textsuperscript{639} See, e.g., Lynn Bonner, Payday-Loan Industry States Case to North Carolina House Committee, Knight-Ridder Trib. Bus. News, July 26, 2001 (quoting a representative of Advance America, one of the largest lenders, as stating, "frequent use is not always bad"), 2001 WL 25351635; Kevin Corcoran, Indiana Court to Issue Ruling on State's 'Payday Lending' Industry, Knight-Ridder Trib. Bus. News, May 29, 2001 (indicating that a lawyer for a payday lender argued before the Supreme Court of Indiana that it would be wrong for the court to substitute its decision for the choices of payday loan consumers, 2001 WL 21908572; Carolyn Said, Long Way from Payday: Some Say Short-Term Loan Stores Are a Needed Service, Others Say They're Not Much More than Legalized Loan-Sharking, S.F. Chron., June 17, 2001 (indicating that the owner of twenty-two check-cashing and payday loan stores contended that the proposed California bill to regulate payday lending was "paternalistic" because it removed consumer choice and assumed that consumers are not sufficiently intelligent), 2001 WL 3406626; Amber Veverka, North Carolina Legislators Seek New Limits on Payday Loans, Knight-Ridder Trib. Bus. News, Feb. 22, 2001 (noting that the president of the North Carolina Check Cashing Association argued against a bill limiting rollovers because it interfered with consumer choice), 2001 WL 13625235.
\end{itemize}
then rely on judicial enforcement of the bargain reached unless invalidating doctrines such as fraud or unconscionability demonstrate that the contract was not truly a product of mutual assent.\textsuperscript{641} Economic theory provides an alternative justification for judicial enforcement of contractual intent.\textsuperscript{642} Under an economic analysis, contracts arise from the process of self-interested parties bargaining to achieve individual wealth maximization.\textsuperscript{643} Economic theory assumes that contracting parties are fully informed, rational actors who possess the ability to bargain over terms.\textsuperscript{644} The theory then assumes that the bargain struck represents an efficient contract that leads to wealth maximization not only for the contracting parties, but for society at large as well.\textsuperscript{645} Accordingly, economic theory produces efficient outcomes only when its "simplified assumptions" approximate reality.\textsuperscript{646}

The results of the Ohio Survey and other surveys contradict any assumption that consumers in payday lending contracts act as informed parties. Even though payday lenders

\textsuperscript{642} Id. at 641-42 (noting that economic theory supports judicial enforcement of contracts because wealth maximization is best enhanced through private bargaining).
\textsuperscript{643} See id. at 642; Michael I. Meyerson, The Efficient Consumer Form Contract: Law and Economics Meets the Real World, 24 GA. L. REV. 583, 585-86 (1990) (arguing that it is not rational for contracting parties to agree to terms that are contrary to their self interest in increasing personal wealth).
\textsuperscript{644} Dimatteo, supra note 641, at 642.
\textsuperscript{645} Meyerson, supra note 643, at 593; see also Cohen, supra note 640, at 562-63 ("[A] regime in which contracts are freely made and generally enforced gives greater scope to individual initiative and thus promotes the greatest wealth of a nation.").
\textsuperscript{646} Meyerson, supra note 643, at 593. As one scholar noted,

In order to facilitate mathematical formulation and exposition, neoclassical economic theory routinely adopts what appear to be, and often are, from both a physical and a psychological standpoint, highly unrealistic assumptions: that individuals and firms are rational maximizers, that information is costless, that the demand curves of individual firms are infinitely elastic, that inputs and outputs are infinitely divisible, that cost and revenue schedules are mathematically regular, and so forth.

are marketing a new product, as previously discussed, 73% of the payday lenders in the Ohio Survey did not have pamphlets or brochures about payday loans available for a potential customer to peruse, 68% of the payday lenders surveyed refused to allow the customer to have a copy of the application to take home and review, and even after contract-consummation, only 18% of the payday lenders gave the customer a copy of his or her signed application. Moreover, when payday lenders were asked during the information-gathering stage to state the APR for a $100 loan, 68% violated TILA by denying the existence of an APR, claiming lack of knowledge about the APR, stating the APR equaled the finance charge, or avoiding giving a clear answer. In violation of TILA's advertising requirements, a whopping 84% of the lenders used fee schedules that did not state an APR for each loan amount. Likewise, in violation of TILA's timing of disclosure requirement, 77% of the lenders did not allow the surveyors to leave the store with a copy of the contract for review prior to consummating the deal. Remember that the CFSA is purportedly committed to the best practice of allowing cost-free rescissions, yet, 50% of the CFSA members in the Ohio Survey did not allow such rescissions when the customer tried to do so. Finally, recall the numerous examples of payday lenders threatening bad-check prosecution in jurisdictions where the payday loan customer's conduct did not constitute a crime.


648. See infra App., tbl.2; see also supra Part II.A.2.a.ii. For a discussion of TILA's requirements, see supra note 173 and accompanying text.

649. See supra note 196 and accompanying text. For a discussion of TILA's advertising requirements, see supra note 197 and accompanying text.

650. See supra notes 166-67 and accompanying text; infra App., tbl.3. For a discussion of TILA's disclosure requirement, see supra note 209 and accompanying text.

651. See BEST PRACTICES, supra note 154.

652. See supra note 245 and accompanying text.

653. See supra notes 460-71 and accompanying text.
These violations show that payday lenders distort information in order to take advantage of the customer's ignorance. Usually, an asymmetry of information exists between merchants and consumers, and merchants maintain a better position from which to distort the information. Such asymmetry is arguably unfair. Yet, merchants, like payday lenders, exacerbate this unfairness when they distort information out of an economic incentive. "When one party interferes with the 'objectivity' of another's choice, the moral reverberations swell, especially when the interferer gains from it." Payday lenders are undoubtedly profiting from their exacerbation of asymmetrical information. As shrewd businesspersons, they entice customers with advertisements that promise a convenient way for cash-strapped consumers to quickly get a loan without undergoing a credit check. As predators in violation of numerous laws, payday lenders earn lucrative profits by using a host of tactics such as hiding the triple-digit APRs until after contract consummation, charging fees in excess of state law, and misrepresenting their ability to have defaulting customers thrown in jail. Consequently, a market failure exists in the payday loan industry. Because

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656. See id. at 1004-05 (noting the moral concerns associated with a market that systematically benefits the merchants at the consumers' expense). For an example of unfairness in another context, see Jill S. Kingsbury, "Must We Talk About that Reasonable Accommodation?: The Eighth Circuit Says Yes, but Is the Answer Reasonable?", 65 MO. L. REV. 967, 1001-02 (2000) ("[W]hen information asymmetries exist between the employer and employee [in a case under the Americans with Disabilities Act], the court's decision leaves employees with an unfair burden of proof, employers with an incentive to derail employees' claims, and society footing the bill.").
657. Kuklin, supra note 655, at 1005 (arguing that moral concerns over fairness in the marketplace heighten when merchants capitalize on inherent distortions for personal gain).
658. Id.
659. See supra note 36 and accompanying text.
660. See supra notes 156-271 and accompanying text (analyzing payday lenders' failure to provide disclosures required by law), supra notes 130-54 and accompanying text (describing the interest rates charged for payday loans), supra notes 457-71 and accompanying text (discussing payday lenders that seek prosecution of customers who default on payday loans).
the market works unfairly and inefficiently, governmental regulation is justified.\textsuperscript{662} To be most effective, as will be shown, this regulation should stem from federal rather than state government action.

B. WHY STATE-BY-STATE REGULATION WOULD BE INADEQUATE

Each state, of course, can and should act to regulate the payday loan industry, but Congress is the only legislative body that can regulate it adequately and effectively. State-by-state efforts at regulation are inadequate and inefficient because, as explained below, the rent-a-bank practice circumvents state laws designed to protect consumers, and many states do not afford consumers a base level of necessary protections.\textsuperscript{663} The


\textsuperscript{663} While it is true that states can pass laws to deal with matters traditionally reserved to the states, only Congress can effectively address the rent-a-bank problem. Currently, there is a gross disparity in state law protections available to payday loan customers. Congress should enact legislation affording every consumer basic protections from payday loan abuses because state action has failed to redress consumer concerns. The failure of the states to adequately address unfair consumer debt collection practices led to the enactment of the FDCPA. \textit{See} John Tavormina, \textit{The Fair Debt Collection Practices Act—The Consumer's Answer to Abusive Collection Practices}, 52 TUL. L. REV. 584, 587 (1978). Similarly, the FTC has ensured consumers will not fall victim to the Uniform Commercial Code's holder in due course doctrine after entering into a consumer credit contract. FTC rules require consumer credit contracts to include a notice informing any holder of the note that payment is subject to any claims or defenses of the debtor against the contracting creditor. FTC Reservation of Consumers' Claims Rule, 16 C.F.R. § 433.2 (2002). The holder in due course doctrine serves to exempt subsequent transferees of promissory notes or other negotiable instruments
rapidly spreading rent-a-bank practice thwarts the efforts of state lawmakers to provide the barest consumer protection.664 “Usury laws are, at core, the earliest form of consumer protection law.”665 As stated previously, in nineteen states, Puerto Rico, and the Virgin Islands, payday loans are technically illegal because these loans carry triple-digit interest rates that exceed the double-digit interest rates permitted by law.666 Payday lenders use rent-a-bank primarily to charge fees in excess of these usury limits.667 Moreover, payday lenders are not content to simply evade usury laws where payday loans are illegal. Rather, payday lenders have begun, and will continue, to use bank charters to extract from consumers fees in excess of the triple-digit interest rates668 already allowed in states where the loans are legal.669 Amazingly, some payday lenders appear dissatisfied with receiving fees carrying legalized interest rates ranging from

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<td>For a discussion about payday lenders circumventing state laws, see supra notes 560-562 and accompanying text.</td>
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<td>Drysdale &amp; Keest, supra note 16, at 657</td>
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<td>666</td>
<td>See supra note 146 and accompanying text. In Virginia, ACE and Advance America were issuing loans at an APR of 442% even though Virginia’s small loan cap is 36%. Fox &amp; Mierzwinski, supra note 63, at 12.</td>
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<td>667</td>
<td>See Fox &amp; Mierzwinski, supra note 63, at 12. The CFA’s 2001 survey found an average APR of 606% in six states that prohibited payday loans through their usury limits. Id. at 3. See, e.g., Jeff Gelles, The Philadelphia Inquirer Consumer Watch Column, KNIGHT-RIDDER TRIB. BUS. NEWS, Nov. 14, 2001 (describing the partnership between National Cash Advance in Pennsylvania and People’s National Bank in Paris, Texas where payday loan customers were charged $17 per $100 for a two-week loan—an annual rate of 442%, which is more than eighteen times the legal limit in Pennsylvania), 2001 WL 30265902.</td>
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<td>As stated previously, currently twenty-three states and the District of Columbia have statutes that authorize payday lending. See supra note 120 and accompanying text. The majority of these states set a maximum fee for payday loans, but the maximum fee for each state carries a triple-digit APR ranging from 240% in Oklahoma to 780% in Wyoming. Fox &amp; Mierzwinski, supra note 63, app. B at 27-29.</td>
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<td>669</td>
<td>See, e.g., Nicole Duran, Colo. Sues Payday Lender over Bank Deal, AM. BANKER, July 25, 2001, at 4 (indicating that the Colorado Attorney General filed a lawsuit against ACE, accusing ACE of attempting to circumvent Colorado payday loan laws by partnering with Goleta National Bank and “making or arranging more than one renewal of a payday loan at the maximum payday loan finance rate”), available at 2001 WL 3913025.</td>
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240% to 780%. As one exasperated state senator exclaimed, "Ten times the prime ought to be enough for anybody." Although urged by state and federal regulators to comply with interest rate ceilings, many payday lenders cross the lines drawn by state lawmakers on how much profit they can derive from desperate consumers. Last year, the Ohio Department of Commerce issued a Notice of Intent To Issue a Cease and Desist Order against ACE. After partnering with Goleta National Bank, ACE dropped its payday lending license and charged fees 13% above Ohio's legalized effective APR of 391%. ACE's defiance of state laws has led it to defend against state regulators in Ohio, Colorado, Florida, Indiana, Maryland, and Texas. In addition to being under investigation in North Carolina for violating state law, the North Carolina Commissioner of Banks ordered payday lenders to "make no further payday loans after August 31, 2001, either directly or as agent for another, since they are without legal authority to enter such transactions." Approximately three

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670. Supra note 668 (stating that although the majority of these states set a maximum fee for payday loans, the maximum fees equate to triple-digit APRs ranging from 240% in Oklahoma to 780% in Wyoming).
672. In re ACE Cash Express, Inc., No. 01-SL-01 (Dep't of Commerce, Div. of Fin. Insts. July 16, 2001) (on file with author); see supra note 599 and accompanying text.
673. Pramik, supra note 600; see also Murray, supra note 596 (indicating that ACE charged 442% interest).
674. Fox & Mierzwinski, supra note 63, at 18-19 nn.33-35; see also Colorado Challenges "Rent-A-Bank", supra note 598, at 40 (indicating that prior to Colorado's lawsuit, ACE had been "warned against acting as an unlicensed supervised lender and was ordered to cease and desist from such lending and to refund to consumers all excessive and improper finance and other charges collected in renewing the loans . . . and assessing fees in violation of Colorado law"). As a result of the rent-a-bank practice, state regulators sometimes feel powerless to protect consumers from exorbitantly priced payday loans. See generally Geller, supra note 2 (discussing the frustration felt by state regulators who feel that "if the practice known as 'charter-renting' continues, they may be powerless to rein in payday lending").
months later, state Attorney General Roy Cooper began investigating payday lenders. In response to the investigation, the legal counsel for the CFSA, said, “If it’s a national or a state bank making the loan, then there are no limits . . . . We trust the [North Carolina] Attorney General’s Office has lawyers who are smart enough to know that.”

This legal posture contradicts the CFSA’s second best practice standard: “A member will not charge a fee or rate for a payday advance that is not authorized by State or Federal law.”

Like many payday lenders, some banks ignore warnings from banking regulators. As explained in Part III of this Article, some payday lenders and banks rely on federal preemption available to national and state-charted banks under the National Bank Act and DIDMCA to excuse their noncompliance with state-law interest limitations. The California Department of Financial Institutions warned traditional lending institutions not to partner with payday lenders because “an institution’s reputation may be associated and potentially damaged by the lending practices of some of the more unscrupulous payday lenders.” The OCC and the Office of Thrift Supervision (OTS) warned national banks and federal thrifts about consumer protection concerns arising from banks and thrifts entering into contractual arrangements with third parties to fund payday loans. The OCC also notes that the third-parties should not “automatically assume that the benefits of the bank or thrift charter will accrue to them by

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677. Id. (internal quotations omitted).
678. BEST PRACTICES, supra note 154 (emphasis added).
679. See infra notes 681-89 and accompanying text.
680. See discussion supra Part III.B.2.
virtue of such relationships." Yet, many traditional lending institutions and payday lenders seem undeterred in their quest to form partnerships.

Because federal banking law clearly authorizes banks to export their interest rates, only Congress, not banking regulators, state lawmakers, or the courts, can successfully prevent rent-a-bank. As stated by the United States Supreme Court in Marquette, "[T]he protection of state usury laws is an issue of legislative policy, and any plea to alter [Section 85 of the National Bank Act] to further that end is better addressed to the wisdom of Congress than to the judgment of this Court." On March 15, 2001, Representative John LaFalce, senior Democrat on the House Financial Services Committee, introduced a bill that would prohibit federally insured banks from making "any payday loan, either directly or indirectly" or from making a loan to another lender for purposes of financing or refinancing payday loans. Congress has failed to act on this bill; therefore, the preemption doctrine effectively prevents state lawmakers from deciding what double- or triple-digit interest rate is fair for the industry to charge risky


684. Fox & Mierzwinski, supra note 63, at 19-20 (showing that several banks have partnered with dozens of payday lenders). Currently, Crusader Savings Bank of Philadelphia is perhaps the only bank that has terminated its partnership with a payday lender after being investigated by banking regulators. It did so after being purchased by another bank. Id. at 19 n.36 (indicating that Crusader was in partnership with National Cash Advance). See generally Joseph N. DiStefano, The Philadelphia Inquirer Loose Change Column, KNIGHT-RIDDER TRIB. BUS. NEWS, Aug. 28, 2001 (indicating that Crusader was purchased by Royal Bank), 2001 WL 26628374. OTS was concerned about Crusader's "reliance on risky income sources, such as the payday loans, and a lack of internal accounting controls." Andy Gotlieb, Bank Abandons Loans Questioned by OTS, PHILA. BUS. J., Jan. 19, 2001 (indicating that payday loans were profitable for Crusader but the bank ceased payday loan operations after OTS charged it with being engaged in unsafe or unsound practices due to its business with National Cash Advance), http://philadelphia.bizjournals.com/philadelphia/stories/2001/01/22/focus2.html (last visited Aug. 26, 2002).


Congress should amend banking law to prevent banks from being a tool for payday lenders to ignore state law and exploit consumers. In amending federal banking law, Congress should be guided by the words of North Carolina Attorney General Roy Cooper: "We don't believe bank charters were created to enable companies to circumvent laws that are designed to protect consumers."

Congress needs to act not only to preclude the rent-a-bank practice but to afford consumers basic protections from treble damages, rollover fees, and criminal prosecution. A state-to-state comparison of payday lending statutes reveals a lack of uniformity, with the majority of states providing little protection to consumers. The paucity of protection stems from the fact that many states have enacted industry-sponsored legislation. Only a few states expressly prohibit payday lenders from collecting treble damages. Fairness dictates that payday loan debtors should not be liable for treble damages for defaulting on a payday loan. If a consumer

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687. United States Bill Tracking, 2001 United States House Bill No. 1055, 2001 U.S. H.B. 1055 (SN) (Westlaw) (showing no action since the bill was referred to the Committee on Financial Services upon introduction) (last visited Sept. 16, 2002).

688. If Congress can give $15 billion in corporate welfare to bail out the airline industry (after the September 11 terrorist attack), it should be able to address the payday lending abuses. See William M. Welch, Experts Predict Deficits Will Last Years, USA TODAY, Nov. 20, 2001, at A8 (discussing economic problems that arose from Congress's response to the terrorist attack), available at 2001 WL 5476802.

689. Serres, supra note 676.

690. See generally ELIZABETH RENUART, AARP PUB. POLICY INST., PAYDAY LOANS: A MODEL STATE STATUTE (2000) (describing the law in each state applicable to small, short-term loans and making the case for a model payday loan statute).

691. Fox, supra note 12, at 993. After losing court battles over the nature of payday loan transactions, the industry lobbied for legislation authorizing payday lending and exempting payday loans from usury statutes. See Keest, supra note 44, at 1117 ("[A]t the outset, the post-dated check lenders took the position they were not lending money, and so no credit laws were implicated. As the case law rejected this position, the industry sought enabling legislation.").

692. See supra note 443.

693. Apparently, a few states believe it is unfair for payday lenders to collect under statutes designed to compensate victims of bad-check fraud because they expressly make those statutes unavailable to payday lenders in collection actions. See e.g., COLO. REV. STAT. § 5-3.1-12 (2000) (stating that "the lender shall have the right to exercise all civil means authorized by law to
defaults on his car loan, credit card, or residential mortgage, a lender cannot collect treble damages. Why should payday loan debtors be subject to this collection practice simply because the medium used to receive the loan happens to be a check? Congress should close loopholes in states that allow lenders to collect treble damages.

Like the collection of treble damages, the rollover practice deserves Congress’s attention. States that merely permit payday lending due to a lack of usury limits, ignore the practice of rollovers. In states that expressly authorize payday lending, some statutes prohibit rollovers while others limit them and/or require a notice to consumers. As explained extensively in Part II of this Article, the rollover data demonstrate that a significant minority, and in some states, a majority, of payday loan customers roll over payday loans. The rollover practice reveals a host of consumers running on the debt treadmill seemingly unable to get out of debt, and no one knows how many of them have had to file bankruptcy.

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collect the face value of the instrument; except that the provisions and remedies of section 13-21-109,” which includes remedies for victims of bad-check fraud, are not available to the lender); TENN. CODE ANN. § 45-17-112(i) (Supp. 2000) (stating that payday lenders cannot collect, inter alia, treble damages or attorney’s fees); 2002 Va. Acts ch. 897 (stating that a payday lender “shall not be entitled to collect or recover from a borrower any sum otherwise permitted pursuant to § 8.01-27.2,” which provides civil remedies, including treble damages, in bad-check lawsuits). Consequently, lenders cannot use these statutes to collect treble damages or attorney’s fees.

694. Montana recognizes that some payday lenders try to use bad-check statutes to exact remedies not generally available to other creditors suing borrowers who have defaulted on consumer loans. Therefore, in Montana, payday lenders applying for a lending license must provide a sworn statement that they “will not in the future, directly or indirectly, use a criminal process to collect the payment of deferred deposit loans or any civil process to collect the payment of deferred deposit loans not generally available to creditors to collect on loans in default.” MONT. CODE ANN. § 31-1-705(3)(c) (2001) (emphasis added); id. § 31-1-723(2) (prohibiting such collection practices).

695. See generally RENUART, supra note 690 (describing the law in each state and demonstrating that states lacking usury laws have not passed any laws to provide protections to payday loan customers).

696. For example, Colorado allows one rollover, COLO. REV. STAT. § 5-3.1-108, and requires the following notice to be placed in the payday loan contract: “RENEWING THE DEFERRED DEPOSIT LOAN RATHER THAN PAYING THE DEBT IN FULL WILL REQUIRE ADDITIONAL FINANCE CHARGES.” Id. § 5-3.1-104.

697. Steven Gardner, Choosing Bankruptcy: Personal Bankruptcy Filings in Clark County Are up 29.3 Percent over Last Year, COLUMBIAN (Vancouver, Wash.), Dec. 9, 2001 (describing a rollover payday borrower, Roger, who filed for bankruptcy), 2001 WL 27877664, at *6.
Notions of fairness dictate a congressional limitation on or prohibition against rollovers. Numerous stories exist detailing how payday lenders use rollover fees to collect more than double the original loan, yet leave some consumers still owing the original loans.698 These stories demonstrate that a host of payday lenders lack a commitment to fair lending practices; these lenders, driven by a desire for profits, will not limit the number of rollovers in the absence of a legislative mandate.699 Moreover, the payday lenders' use of rent-a-bank to exceed rollover limits further serves as a testament to their lack of commitment to fair lending practices. These lenders ignore laws limiting rollovers and contend that the rollover fees, like the original loan fees, are protected by the preemption doctrine in federal banking law.700 Consequently, state law regulation cannot effectively address rollovers as well as usury limits. By preventing rent-a-bank and prohibiting or limiting rollovers, Congress can play a vital role in bringing protection to consumers nationwide and keep thousands of consumers off the debt treadmill and hopefully out of bankruptcy.

Like the response of states to the rollover practice, some states remain silent about bad-check prosecution of payday loan customers while other states either ban it outright or ban it unless, prior to the loan's due date, the customer closed her bank account or stopped payment on the check.701

698. See, e.g., Geller, supra note 2 (indicating that Leticia Ortega, who had her bank account debited by National Money Service $90 every two weeks for almost a year to roll over a $300 loan, paid $1800 in fees); Wayne Heilman, “Payday” Loans Draw Interest/Quick Lenders Charge 451 Percent in Colorado, GAZETTE (Montreal), Nov. 25, 2001 (indicating that a consumer obtained a $300 loan from Colorado Pay Day Loans, Inc., and eventually paid $540 in interest by “paying back the loan and immediately taking out a new loan for the same amount—eight times”), 2001 WL 27140868; NPR Broadcast, supra note 275 (describing a woman who borrowed $800 from a payday lender to pay for car repairs and ultimately wound up paying more than $10,000 in loan fees to multiple lenders), 2001 WL 9328000.

699. There are several laws in America that strike a proper balance between offering individuals basic protections and giving businesses the opportunity to earn profits. For example, the Occupational Safety and Health Act's stated purpose is “to assure . . . every working man and woman in the Nation safe and healthful working conditions.” 29 U.S.C. § 651(b) (2000).

700. OCC Weighs In, supra note 341, available at 2001 WL 26574239. ACE claims that its “renewals [or rollovers] were made in partnership with Goleta National Bank of California and that they were permitted by the National Bank Act.” Id.

701. See e.g., sources cited supra notes 502-03.
additional consumer protection, a few states require a notice in the contract informing the consumer of his or her rights regarding bad-check prosecution.702 Because only a few states expressly preclude payday loan debtors from being criminally prosecuted for writing bad checks, many payday loan customers still are subject to prosecution. Long ago, America did away with debtors' prison,703 a system founded on the erroneous assumption “that all creditors were honest, and all debtors dishonest.”704 Most state constitutions contain provisions prohibiting imprisonment for debt.705 These provisions “were adopted to protect the ‘poor but honest’ debtor who is unable to pay his or her debts.”706 South Dakota's constitution provides wisdom on the issue of prosecution of payday loan debtors because it provides that “[n]o person shall be imprisoned for debt arising out of or founded upon a contract.”707 Payday loan prosecutions concern the breach of a contract to repay a loan, not the deceptive practice of convincing a creditor that a bad check was good.708 Consequently, no consumer obtaining a payday loan should fear incarceration simply because they obtained a loan by writing a check. Payday loan debtors should be on equal footing with consumers who obtain cash advance loans by using their credit cards; credit card borrowers are not subject to prosecution.709 Fairness dictates that all Americans

702. See supra note 505 and accompanying text.
703. See supra notes 507-08 and accompanying text.
705. See supra note 703.
707. S.D. CONST. art. VI, § 15.
708. See supra Part II.B.2.d (analyzing state law regarding bad-check prosecution of payday loan customers). Situations do exist where one can conclude that a customer had an intent to defraud when he or she obtained a loan. For example, if Bill failed to repay four payday loans, all obtained on the same day, and the aggregate of those loans exceeded his paycheck, one could find that he had no intent to repay the loans when he obtained them and therefore should be convicted of passing bad checks. See State v. Hogrefe, 557 N.W.2d 871, 879 (Iowa 1991) (“[C]riminal liability should attach if at the time the defendant issued the check, the defendant (1) never had the intention to pay the check or (2) knew he or she would not be able to pay it.”).
709. Because payday lenders use checks as the vehicle for issuing loans, payday loans are the only type of consumer credit that can subject those who default to criminal liability and civil liability for treble damages. Dysdale & Keest, supra note 16, at 611 (“Though default on a normal consumer credit
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should be free from bad-check prosecution if the crime is based on failure to repay a payday loan. Congress should grant all Americans this freedom by passing federal legislation regulating the payday loan industry.

In addition to enacting legislation to address specific problems such as bad-check prosecution, Congress needs to act because concerned politicians and consumer advocates have been largely unsuccessful in convincing state legislators to enact legislation to protect payday loan customers. Except in Illinois, lawmakers in states lacking usury limits failed last year to pass legislation either banning payday loans or regulating the industry. Most states that specifically authorize payday lending failed to amend payday lending statutes to provide greater consumer protections. Evidently, because the majority of these states passed industry-sponsored payday loan bills, many lawmakers think the industry offers consumers a valuable service not otherwise available. Undoubtedly, payday lenders provide a service, but they have no right to provide the service on whatever terms they choose;

debt may trigger delinquency fees and collection fees, [payday] check loans are the only type of consumer debt we know of which conceivably trigger treble-damages penalties upon default—penalties established by the civil bad check laws of some states.”).

710. The reluctance of state prosecutors to proceed against payday lenders is another reason why Congress should not rely on state lawmakers to protect their consumers from predatory payday lending practices. Professor Iain Ramsay, who recently conducted a survey of payday lending in Canada, implies that the authorities are not interested in prosecuting lenders who violate criminal usury statutes. David Menzies, Waiting for Payday: Storefront Money Lenders Offer Loans to People with Credit Troubles, NAT'L POST, Sept. 22, 2001, at D4, 2001 WL 28022514. According to Professor Ramsay, “One reason for the hesitancy to prosecute is there is a general sense that if they prosecuted these companies—which are meeting a need—then lenders would go underground and there would be more loan sharkining.” Id.

711. See, e.g., S.B. 203, 141st Gen. Assem., Reg. Sess. (Del. 2001) (indicating that the Delaware Senate Committee on Banking took no action on a bill designed to prohibit lenders from issuing payday and title loans), WL 2001 DE S.B. 203 (SN); H.B. 870, 45th Leg., Reg. Sess. (N.M. 2001) (indicating that the New Mexico legislature took no action on bill that would have regulated the payday loan industry), WL 2001 NM H.B. 870 (SN); S.B. 84, 95th Leg., Reg. Sess. (Wis. 2001) (indicating that the Wisconsin Senate Committee on Privacy, Electronic Commerce and Financial Institutions took no action on a bill designed to create rules that apply to payday loans), WL 2001 WI S.B. 84 (SN).

712. See, e.g., Jennifer Coleman, Legislation to Regulate Payday Lending Industry Stalled, ASSOCIATED PRESS, Sept. 2, 2001 (reporting that California lawmakers failed to act on two bills, one pro-consumer and one pro-industry), WL, ALLNEWSPLUS; Fox & Mierzwinski, supra note 63, at 9.
the payday lending abuses demonstrate that the industry should be regulated.\textsuperscript{713} Perhaps some proponents of payday lending believe “these people” represent risky borrowers who should have to pay high interest rates to cover financial crises and who do not need protection from predatory payday lenders.\textsuperscript{714} As an example, consider the comments of Republican Representative C.L. “Butch” Otter (Idaho) in response to an article criticizing the payday loan industry:

\begin{quote}
By allowing people to borrow against future earnings, payday lenders provide a safety net for those who need cash to meet emergencies, or who are in control of their finances and are willing to assume debt to take advantage of an opportunity. No one is forced to go to a payday lender, yet these businesses serve hundreds of thousands of men and women every year. Clearly, these lenders are meeting a need in their communities.\textsuperscript{715}
\end{quote}

Perhaps Representative Otter and other lawmakers have not seen the rollover data, or maybe they do not believe the predatory charges lodged against the industry.\textsuperscript{716} Payday loan industry lobbyists aggressively work to make sure these positive perceptions of the industry persist.\textsuperscript{717}

\begin{enumerate}
\item\textsuperscript{713} For example, the desperate need for medical services in Appalachian areas should not give unlicensed doctors an unfettered right to provide the services. A similar argument holds true for payday lending.
\item\textsuperscript{714} Tammy Williamson, New Limit Proposed for Payday Lending, CHI. SUN-TIMES, Feb. 26, 2002, at 45 (stating that because customers have poor credit histories, payday lenders must charge high rates and will oppose any bill that limits payday lenders to charging interest rates less than ten times the prime rate), 2002 WL 6449065.
\item\textsuperscript{716} Monetary contributions by payday lenders may have influenced lawmakers to look favorably on the industry. \textit{See, e.g.}, Anita Weier, \textit{Bill Caps Payday Loan Interest}, CAP. TIMES, Oct. 1, 2001, at 4A (presenting a table of Wisconsin Senate Committee members who have received campaign contributions from the payday lending industry), 2001 WL 25527100.
\item\textsuperscript{717} \textit{See, e.g.}, John Hackett, Ethically Tainted, U.S. BANKER, Nov. 2001, at 48, 54 (quoting a statement from a spokesperson for the Democrats on the House Financial Services Committee that payday lenders “have a strong lobby and have worked hard on the state assemblies to pass laws allowing payday loans”), \textit{available at} 2001 WL 4270174; Peter Luke, Payday Loan Centers May Cash in on State Legislation, GRAND RAPIDS PRESS, Oct. 21, 2001, at B1 (indicating that lobbyists for Check 'n Go have persuaded the Michigan legislature to consider a bill legalizing payday loans), 2001 WL 29515242; Eric Stern, \textit{Bill Would Limit “Payday” Loans}, ST. LOUIS POST-DISPATCH, June 26, 2001, at B1 (“The [payday] loan companies—and their dozen or so lobbyists at the [Missouri] Capitol—say they're providing a service to people who need a
In summary, Congress should take on payday lending because consumers will continue to be subject to many abuses perpetrated by the industry because state laws cannot adequately protect them. The payday loan industry’s strong lobby, the apathy of many state lawmakers, and the industry’s rent-a-bank schemes render state efforts inadequate. This Article argues that Congress should afford consumers, at a minimum, the protections outlined below.

C. MINIMUM CONSUMER PROTECTIONS

Assuming Congress can be persuaded to regulate the payday loan industry, it should enact legislation that at least does the following: (1) places a ceiling on the maximum interest rates and fees that lenders can charge, (2) prohibits banks from partnering with payday lenders, (3) forbids the collection of treble damages from customers, (4) bans the criminal prosecution of customers, and (5) prohibits rollovers using the same or multiple lenders. The goals of the legislation should be to provide consistency among the states, to curtail practices that get consumers trapped in the cycle of indebtedness, and to prohibit practices that are fundamentally unfair and morally reprehensible. As explained below, two lawmakers have introduced bills to address problems with payday lending. While neither bill may be politically viable, one more realistically deals with abuses of the payday lending industry, yet still lacks essential protections. No state payday lending statute is a model worthy of emulation. However, Congress

few hundred dollars but can’t borrow the money from a traditional bank.”), 2001 WL 4469059; Tony J. Taylor, Payday Lenders Effectively Banned in North Carolina, KNIGHT-RIDDER TRIB. BUS. NEWS, Sept. 5, 2001 (quoting a Republican politician’s statement that the industry’s “lobby is extremely strong in the [South Carolina] Legislature and it’s difficult to get anything out of committee to regulate the industry”), 2001 WL 27173691.

718. The financial community’s support for payday lending is waning. For example, concern that payday lenders are beginning tax preparation has led H&R Block, among others, to support a pro-consumer payday loan bill in Missouri. E-mail from Jerry Young, Community Organizer, Kansas City Church Community Organization, to Creola Johnson, Assistant Professor of Law, The Ohio State University Moritz College of Law (Dec. 28, 2001, 13:17:49 EST) (on file with author). CUNA, the nation’s largest trade association for credit unions, see COMPENDIUM OF STATE ISSUE PAPERS, supra note 537, at 34, opposes payday lending and “will support federal legislation that would prohibit depository institutions from making any deferred-deposit (payday) loans, either directly or through any affiliate or agent.” Ann Hayes Peterson, CUNA Reports 1999 Financials, CREDIT UNION MAG., Apr. 2000, at 48, 48, available at 2000 WL 11799458.
could adopt specific provisions contained in the various state payday lending statutes to effectively accomplish the goals identified above.

Convinced that the payday loan industry needs to be federally regulated, Representative John LaFalce of New York, senior Democrat on the House Financial Services Committee, introduced H.R. 1055, entitled the Federal Payday Loan Consumer Protection Amendments of 2001.\(^{719}\) LaFalce's proposal would amend the Federal Deposit Insurance Act to prohibit all federally insured banks from making payday loans either directly or through an affiliate, or from making a loan to another lender for purposes of financing or refinancing payday loans.\(^{720}\) LaFalce's bill would also restrict non-banks from issuing payday loans.\(^{721}\) While LaFalce has strong support from other Democrats, a bill that completely bans payday lending in the hands of a Republican-controlled committee is not politically viable.\(^{722}\) This lack of viability may explain why no action has been taken on the bill.

Representative Bobby Rush of Illinois introduced the other payday loan bill, H.R. 1319, entitled the Payday Borrower Protection Act, which if passed would protect payday loan customers from various payday lending practices by setting standards for state payday loan laws.\(^{723}\) The maximum loan amount is $300, which is a substantially greater limitation in comparison to the twenty states that have maximum loan rates of $350 or more and seven states that place no limits on consumer loans.\(^{724}\) Chief among the consumer protections contained in H.R. 1319 is a provision capping payday loan fees

\(^{719}\) H.R. 1055, 107th Cong. (2001). Although introduced and referred to the Subcommittee on Financial Institutions and Consumer Credit during the first session of the 107th Congress in March of 2001, no further action has been taken well into the second session. Gordon, supra note 686 (“Only fifteen lawmakers, all Democrats, have signed on to the bill.”).

\(^{720}\) See H.R. 1055 § 3.

\(^{721}\) See id. § 4(e).

\(^{722}\) See Gordon, supra note 686 (noting that only Democrats have signed on to the bill); Chris Di Edoardo, Payday Loans: Interesting Business, LAS VEGAS REV.-J., Jan. 28, 2001, at F1 (reciting comments by a Democrat that a payday loan bill would not likely be given any attention in a Republican-controlled Congress), 2001 WL 9529145.


\(^{724}\) Fox & Mierzwinski, supra note 63, at 27-29.
at a 36% interest rate. Because H.R. 1319 sets minimum standards for states to follow, states would be at liberty to lower the interest rate, and thereby decrease the profitability of payday lending. The bill brings a modicum of fairness to the industry because consumers across the nation would not have to pay more than the federal APR for payday loans. The 36% APR limitation would drastically reduce the triple-digit APRs normally associated with payday loans, but payday lenders claim they cannot make a profit if they are limited to charging double-digit interest rates. Consequently, this bill may never receive attention unless Democrats are willing to increase the 36% interest rate to triple-digits.

Related to the 36% interest rate limitation is a provision that removes the incentive for payday lenders to use rent-a-bank partnerships. Section 3 of H.R. 1319 would amend the Federal Deposit Insurance Act by allowing an insured depository institution to issue payday loans directly, or indirectly through an agent, only if the loan complies with its state's payday lending law, particularly the interest rate limitation of 36%. By subjecting banks to the same 36% interest rate cap, this provision would destroy the profitable rent-a-bank union because payday lenders could no longer circumvent state-imposed interest rate caps by partnering with banks. Moreover, section 3 would make banks in rent-a-bank arrangements responsible for determining whether the payday lender is complying with state and federal laws.

725. See H.R. 1319, § 4 (b)(7)(D) ("The annual interest applicable to any deferred deposit loan may not exceed the lesser of 36 percent or the maximum annual percentage rate allowable in such state for comparable small loans.").

726. See Indiana Court Limits Payday Lenders, ASSOCIATED PRESS, Aug. 16, 2001 (quoting an attorney for the payday lending industry who claimed that "it wouldn't be feasible for many payday lenders to continue offering small loans because they could only collect pennies on them"), 2001 WL 26180436.


728. See id. § 3(t)(1)(A).

729. See id. § 3(t)(1)(B). Section 3(t)(1)(B) provides as follows:

[An insured depository institution may not make any loan to any payday lender for purposes of financing deferred deposit loans unless the depository institution ascertains that such lender is in full compliance with the Truth in Lending Act, the Electronic Fund Transfer Act, and the law of the state in which any borrower from such payday lender will receive the proceeds of any such deferred deposit loan.
In addition to curtailing rent-a-bank, H.R. 1319 seeks to protect consumers from payday lending practices that arise because a check, or an electronic fund transfer, is used to obtain a payday loan. Section 4(b)(6)(A) precludes the initiation or threat of criminal and civil prosecution of a payday loan debtor other than the initiation of "a proceeding directly related to the collection of [payday loan] debt and actual damages."\(^{730}\) The bill also requires the payday loan contract to contain a "clear and conspicuous" notice that the consumer is free from the initiation or threat of such prosecutions and that the lender is limited to collecting the debt and actual damages.\(^{731}\) By limiting the lender in this fashion, the bill proscribes the collection of treble or double damages under state civil statutes designed to compensate victims of bad-check crimes.\(^{732}\) In addition, it prohibits the prosecution of customers for bad-check crimes.\(^{733}\) H.R. 1319 also prohibits lenders from doing anything that is prohibited for a debt collector under section 808 of the FDCPA.\(^{734}\) For example, under the FDCPA, it is illegal for a debt collector to threaten or institute criminal prosecution for defaulting on a loan unless such an action is lawful and the debt collector intends to take such action.\(^{735}\) Under this bill, it would also be illegal for a payday lender to threaten the same.\(^{736}\)

\(^{730}\) See id. § 4(b)(6)(A).

\(^{731}\) See id. § 4(b)(8)(C).

\(^{732}\) See supra note 730 and accompanying text.

\(^{733}\) Id.

\(^{734}\) See id. § 4(b)(6)(B) (proscribing "any practice which is prohibited under section 808 of the [FDCPA] for a debt collector (as defined in such Act)"); see also 15 U.S.C. § 1692f (listing the prohibited practices).


\(^{736}\) This bill further focuses on limiting exorbitant fees for payday loans. Under the H.R. 1319, collection fees for a returned check (NSF) are limited to $15 or to the charges imposed by the financial institution returning the check for insufficient funds. See H.R. 1319 § 4(b)(7)(G). Section 4(b)(7)(G) provides as follows:

The amount of any fee imposed for any check made or any electronic fund transfer authorized by a borrower in connection with any deferred deposit loan which is returned unpaid to the payday lender due to insufficient funds in an account of such borrower may not exceed the lesser of $15 or the charges imposed by the financial institution returning the check for insufficient funds.

Id. This limitation is fairer than most state statutes that allow the collection
H.R. 1319 contains provisions designed to prohibit certain practices that lead to perpetual indebtedness.\textsuperscript{737} For example, it requires a two-week period of maturity for every $50 amount borrowed.\textsuperscript{738} This provision extends the traditional loan period of two weeks, so that if, for instance, a customer borrows $150, he would have six weeks to repay that loan. This provision would put consumers in the best position to avoid perpetual indebtedness, if it is coupled with a provision similar to Indiana law, which allows customers to make partial payments to reduce the principal prior to the loan's due date.\textsuperscript{739} H.R. 1319 further protects payday loan customers from perpetual indebtedness by forbidding a lender from refinancing or rolling over payday loans, and from issuing a new loan between that lender and its customer within thirty days after payment of a previous loan.\textsuperscript{740} The bill also prohibits a lender from accepting repayment of a payday loan if the lender knows, or has reason to believe, that the funds submitted for repayment are the proceeds from a previous payday loan.\textsuperscript{741} Because the lender may elect to be willfully blind, this provision will not prevent a borrower from getting a second loan from a second payday lender within thirty days of the first loan and, subsequently, does not eliminate rollovers using multiple lenders (the rollover of NSF charges. For example, Ohio payday lenders collect both a $20 fee for returned checks and any fees that are passed on to the lender from a financial institution. H.R. 1319 limits Ohio lenders to collecting either the $15 fee or the fees passed on from the bank. Consequently, the payday lenders may have cake or ice cream, but not both.\textsuperscript{737} See H.R. 1319 § 4(b)(6).

\textsuperscript{738} See id. § 4(b)(7)(A) (stating that "the period to maturity of any deferred deposit loan may not be less than 2 weeks for each $50 of loan principal").

\textsuperscript{739} Under Indiana law, [a] consumer may make partial payments in any amount on the small loan without charge at any time before the due date of the small loan. After each payment is made on a small loan, whether the payment is in part or in full, the lender shall give a signed and dated receipt to the consumer making a payment showing the amount paid and the balance due on the small loan. IND. CODE ANN. § 24-4.5-7-402(3) (Michie 2002). In Louisiana, payday lenders cannot refuse partial payments of $50 or more. LA. REV. STAT. ANN. § 9:3578.6(A)(3) (West 2002). \textsuperscript{740} See H.R. 1319 § 4(b)(6)(F).

\textsuperscript{741} See id. § 4(b)(6)(E). Other prohibited practices include charging additional fees or premiums for credit insurance in conjunction with a deferred deposit loan, and engaging in unfair or deceptive practices. See id. § 4(b)(6)(D), (G).
variation known as “borrowing from Peter to pay Paul”).

In summary, the enactment of H.R. 1319 would provide basic legal protections to payday loan customers. H.R. 1319 contains two additional protections not discussed heretofore. First, many consider the inclusion of arbitration clauses in consumer contracts to be improper or predatory. H.R. 1319 prohibits arbitration clauses in consumer loan contracts or any document in connection with the loan. The wording of this

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742. Some jurisdictions address the “lender knowledge” issue by holding the borrower partially responsible for avoiding the debt treadmill. For example, Kentucky law requires borrowers to attest to not having any loans. See supra note 321 and accompanying text. Florida law goes further to protect the borrower by requiring lenders to verify the existence of outstanding loans through a central database. See supra note 324 and accompanying text. In addition, the borrower must sign an attestation statement. See id. § 560.404(20). Florida’s attestation statement is as follows: “I DO NOT HAVE AN OUTSTANDING DEFERRED PRESENTMENT AGREEMENT WITH ANY DEFERRED PRESENTMENT PROVIDER AT THIS TIME. I HAVE NOT TERMINATED A DEFERRED PRESENTMENT AGREEMENT WITHIN THE PAST 24 HOURS.” Id. For the language that mandates the maintenance and consultation of the database, see supra note 324. By following Florida’s approach to payday lending, Congress would prohibit single and multiple lender rollovers, renewals, and payday loan consolidations. This would greatly reduce the number of people trapped in the rollover cycle.


“There's no question that arbitration is an excellent, wonderful dispute-resolution device.” . . . But if it's so good for consumers . . . then why don't companies make such provisions “very clear and explain everything to consumers,” and not try to hide the terms in bill stuffers or a pile of documents?

Id. (quoting and paraphrasing Professor Mark Budnitz, an ardent critic of mandatory arbitration clauses).

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provision prohibits arbitration clauses that may be hidden in the application form and not contained anywhere in the loan contract signed by the borrower. Finally, H.R. 1319 sets licensing and regulation standards for payday lenders to follow.\textsuperscript{745}

H.R. 1319, however, will not be effective because, even though it mandates that states enact its minimum standards, it does not penalize states that fail to do so. As with other federal statutes, Congress will need to create financial incentives to persuade states to enact the federal payday loan statute.\textsuperscript{746}

Thus far, minimum protections have been analyzed, but Congress can provide additional protections if it embraces the goal of freeing millions of Americans from "financial servitude"—the state of only qualifying for exorbitant sources of credit like payday lending.\textsuperscript{747} Payday lenders seem to inculcate a sense of financial irresponsibility, and they will not help consumers repair their credit histories.\textsuperscript{748} As previously explained, an industry-sponsored survey shows that most payday loan customers lack access to traditional forms of credit.\textsuperscript{749}

Congress should follow the approaches of various states regulating payday lending by enacting legislation that helps consumers establish habits to prudently manage a financial crisis and help them to eventually rebuild their credit histories. For instance, Congress could follow Indiana's approach in dealing with the fact that payday lenders make no real assessment of a customer's ability to repay the loan. Under

\textsuperscript{745} See id. § 4 (outlining a general prohibition on payday loans unless authorized under state law that licenses and regulates such lending).

\textsuperscript{746} For example, states that use race to deny prospective parents the ability to adopt a child risked losing millions in funding from the federal government. See 42 U.S.C. § 674(d)(1) (2000). Relevant agencies in these states may be forced to forfeit up to 5% of their funding for each quarter they are in violation of the Adoption Promotion and Stability Act of 1996. Id.

\textsuperscript{747} GALLAGLY & DERNOVSEK, supra note 295, at 84 (stating that fringe financial providers, which includes payday lenders, "strip away their customers hope by creating a cycle of 'financial servitude'").

\textsuperscript{748} See supra note 322 and accompanying text (noting that payday lenders make no real assessment of a customer's ability to repay a loan); see also discussion supra Part II.B.1 (discussing rollover data and lenders' lack of commitment to fostering consumer responsibility).

\textsuperscript{749} See discussion supra Part III.A (explaining why customers lack access to traditional forms of credit).
Indiana law, a payday lender cannot issue a loan that exceeds 20% of a consumer’s monthly net income. This income-based limitation would constrain the practice of encouraging consumers to take out the maximum loan amount for which they are approved. If Ohio had a similar income-based loan limitation, the surveyors in the Ohio Survey would have only been eligible for loans up to $160. Ideally, in addition to requiring lenders to limit loans based on income, a payday loan statute should require lenders to inquire about, and limit loans based on, large expenses such as housing and car payments.

This ideal may, however, impose undue additional burdens on lenders by requiring them to revise applications to include more information and purchase software to analyze when a loan should be given. The result may be that consumers are denied loans because payday lenders begin to act too much like traditional lenders in assessing ability to repay. Ultimately, Congress, like Indiana, may conclude that the proper balance may be to require lenders to limit loans based on a consumer’s net income.

Florida is another state that provides consumer protections to payday loan customers that are worthy of implementing on a federal level. As previously discussed, Congress should

750. IND. CODE ANN. § 24-4.5-7-402 (Michie 2002). Chapter seven further defines “monthly net income” as “the income received by the consumer in the four (4) week period preceding the consumer’s application for a small loan under this chapter and exclusive of any income other than regular net pay received, or as otherwise determined by the department.” Id. § 24-4.5-7-110.

751. Recall that, in the Ohio Survey, lenders tried to persuade the research assistants to get $300 loans even though they requested only $50 loans. See supra note 167 (explaining that surveyors were not wired with any audio or video recording equipment and therefore no direct evidence exists that these statements were made).

752. The surveyors earned $8.65 per hour and most worked only part-time hours.

753. Perhaps, the income limit should be lower than 20% given that most traditional mortgage lenders will not finance a mortgage payment exceeding 30% of a borrower’s income. Ruth Simon, Lenders Tout Interest-Only Mortgages, WALL ST. J., Apr. 16, 2002, at D3 (stating that although the norm is between 25% and 30%, some lenders are currently financing mortgages with monthly payments up to 42% of a borrower’s income).

754. Florida’s legislative intent is to prohibit rollovers and to “prevent fraud, abuse, and other unlawful activity associated with” payday loans. FLA. STAT. ANN. § 560.408(1) (West 2002); see also Juanita Jordan, Florida Financial Agency to Implement Law Controlling Payday Loans, KNIGHT-RIDDER TRIB. BUS. NEWS, Sept. 6, 2001 (quoting a lobbyist with Florida Legal Services
adopt Florida's requirement that the state maintain an electronic database to prevent lenders and customers from rolling over loans using the same or multiple lenders.\textsuperscript{755} Congress should also follow Florida's requirement that lenders give a customer who cannot repay a loan by its due date a 60-day grace period with no additional charges to repay the loan.\textsuperscript{756} This grace period should be combined with the previously discussed requirements that customers receive a two-week period of maturity for every $50 amount borrowed, and that customers be allowed to make partial payments to reduce the principal prior to its original due date.\textsuperscript{757}

As a condition to receiving the 60-day grace period, Florida requires the customer seek credit counseling from an approved list of credit counseling agencies.\textsuperscript{758} Credit counselors help consumers learn to budget their money and to readjust spending and buying habits to realistically deal with their debts.\textsuperscript{759} By requiring payday loan customers in need of the

\begin{itemize}
  \item stating that the purpose of the legislation was to curtail the cycle of debt that payday loan customers experience), 2001 WL 27173608.
  \item \textsuperscript{755} See supra note 395 and accompanying text.
  \item \textsuperscript{756} FLA. STAT. ANN. § 560.404(22)(a) (West 2002). Additionally, Florida requires that the following notice of the grace period appear in the payday loan contract:

\begin{quote}
  IF YOU INFORM THE PROVIDER IN PERSON THAT YOU CANNOT COVER THE CHECK OR PAY IN FULL THE AMOUNT OWING AT THE END OF THE TERM OF THIS AGREEMENT, YOU WILL RECEIVE A GRACE PERIOD EXTENDING THE TERM OF THE AGREEMENT FOR AN ADDITIONAL 60 DAYS AFTER THE ORIGINAL TERMINATION DATE, WITHOUT ANY ADDITIONAL CHARGE. THE DEFERRED PRESENTMENT PROVIDER SHALL REQUIRE THAT YOU, AS A CONDITION OF OBTAINING THE GRACE PERIOD, COMPLETE CONSUMER CREDIT COUNSELING PROVIDED BY AN AGENCY INCLUDED ON THE LIST THAT WILL BE PROVIDED TO YOU BY THIS PROVIDER. YOU MAY ALSO AGREE TO COMPLY WITH AND ADHERE TO A REPAYMENT PLAN APPROVED BY THAT AGENCY. IF YOU DO NOT COMPLY WITH AND ADHERE TO A REPAYMENT PLAN APPROVED BY THAT AGENCY, WE MAY DEPOSIT OR PRESENT YOUR CHECK FOR PAYMENT AND PURSUE ALL LEGALLY AVAILABLE CIVIL MEANS TO ENFORCE THE DEBT AT THE END OF THE 60-DAY GRAACE PERIOD.
\end{quote}

\textit{Id.} § 560.0404(20).

\item \textsuperscript{757} See supra notes 738-39 and accompanying text.
\item \textsuperscript{758} FLA. STAT. ANN. § 560.404(20) (West 2002).
\item \textsuperscript{759} See, e.g., \textit{In re Fitzgerald}, 155 B.R. 711, 716 (Bankr. W.D. Tex. 1993) (indicating that credit counseling agencies “will help debtors put together a budget, negotiate stand-still agreements with their creditors, and devise a repayment program within the debtor’s ability to perform”); Teresa A. Sullivan et al., \textit{The Persistence of Local Legal Culture: Twenty Years of Evidence from
grace period to receive credit counseling, Florida puts payday loan customers in a position to repair their credit by learning how to pay off all creditors, not just payday lenders, and by consistently paying their bills on time. Improved credit histories empower these persons to obtain loans at prime rates, rather than subprime rates. Accordingly, Congress should enact a statute like Florida's statute by requiring a grace period and credit counseling for payday loan customers who are unable to repay loans.

Assuming that Congress allows payday lenders to charge triple-digit interest rates, the foregoing restrictions should allow the payday loan industry to remain profitable and yet afford consumers some minimum protections. While this Article cannot discuss in detail additional important restrictions on payday lending, it urges Congress to adopt the following key provisions of state payday lending statutes.


760. Joe Catalano, Tips for Buyers: Getting over the Credit Hurdle, NEWSDAY, May 26, 2000 (quoting the director of Fannie Mae's New York Partnership Office as stating that paying bills on time for a substantial period of time was the only way to repair damaged credit), 2000 WL 10015964.

761. See Hank Ezell, 10 Steps to a Debt-Free Life: Financial Health Takes Planning and Willpower, ATLANTA J.-CONST., Jan. 16, 2000, at H3 ("If you have been paying on time, you may be able to negotiate a lower rate with the creditor."), available at 2000 WL 5435852; Jack Sirard, Keeping a Solid Credit Rating Is Key to Getting Loans, KNIGHT-RIDDER TRIB. BUS. NEWS, Oct. 30, 2001 (explaining that a consumer's ability to get a good credit score to obtain a loan at the lowest possible rate depends on "paying all your bills on time"), 2001 WL 29431098.

762. Jeff Ostrowski, of the Palm Beach Post, reported as follows:

A state crackdown last year on car title loans made that business unprofitable . . . . But payday loans will remain profitable . . . . "This new statute makes everything very black and white and very easy for the state to regulate, which is what we all want . . . ."

First, to prevent disguised payday loan transactions, Congress should prohibit the conditioning of loans on the consumer's purchase of additional goods or services.\textsuperscript{763} Second, rather than relying on general UDAP statutes,\textsuperscript{764} Congress should follow a few states that expressly prohibit payday lenders from engaging in fraudulent and/or unfair and deceptive acts, practices, or advertisements.\textsuperscript{765} Third, like two states—Colorado and North Dakota—Congress should require payday lenders to permit cost-free rescissions.\textsuperscript{766} Because the industry has already adopted this as a best practice,\textsuperscript{767} mandating cost-free rescissions should not pose a problem for the industry. Fourth, Congress should adopt Montana's prohibition against using a device or agreement that would have the effect of charging or collecting more fees, charges, or interest than allowed by this chapter, including, but not limited to:

\begin{itemize}
  \item [(i)] entering a different type of transaction with the consumer;
  \item [(ii)] entering into a sales/leaseback arrangement;
  \item [(iii)] catalog sales; or
  \item [(iv)] entering any other transaction with the consumer that is designed to evade the applicability of this chapter.
\end{itemize}

\textsuperscript{763} ARIZ. REV. STAT. ANN. § 6-1259(B)(12) (West 2001) (stating that lenders cannot "[t]ie or otherwise condition the offering of deferred presentment services to the sale of any good or service"); LA. REV. STAT. ANN. § 9:3578.6(A)(6) (West 2002) (stating that lenders cannot "[s]tructure the repayment of a loan in such a manner as to attempt to circumvent the provisions of this Chapter"); MONT. CODE ANN. § 31-1-723(6) (2001) (prohibiting lenders from "using any device or agreement that would have the effect of charging or collecting more fees, charges, or interest than those allowed by this part, including but not limited to entering into a different type of transaction"); TENN. CODE ANN. § 45-17-112(r) (2000) (banning lenders from using "any device or agreement . . . with the intent to obtain greater charges than otherwise allowed by law"). A sample of the proposed statutory language is found in Indiana's recently amended Uniform Consumer Credit Code, which bans, using a device or agreement that would have the effect of charging or collecting more fees, charges, or interest than allowed by this chapter, including, but not limited to:

\begin{itemize}
  \item [(i)] entering a different type of transaction with the consumer;
  \item [(ii)] entering into a sales/leaseback arrangement;
  \item [(iii)] catalog sales; or
  \item [(iv)] entering any other transaction with the consumer that is designed to evade the applicability of this chapter.
\end{itemize}

IND. CODE ANN. § 24-4.5-7-410(f) (Michie 2002).

\textsuperscript{764} UDAP refers to state statutes regulating unfair or deceptive acts and practices. A. Brooke Overby, An Institutional Analysis of Consumer Law, 34 Vand. J. Transnat'l L. 1219, 1251 (2001) ("Every state also regulates deceptive advertising under what are generally called unfair and deceptive acts and practices statutes (UDAPS).")

\textsuperscript{765} ARIZ. REV. STAT. ANN. § 6-1259(B)(4), (6); COLO. REV. STAT. § 5-3.1-121; IND. CODE ANN. § 24-4.5-7-410(c), (g); KY. REV. STAT. ANN. § 368.100(8) (Michie 2002); MONT. CODE ANN. § 31-1-723(5), (7); N.D. CENT. CODE § 13-08-12(9) (2001); OHIO REV. CODE ANN. § 1315.44 (Anderson 2002) (deeming violations of section 1315.41 unfair and deceptive acts).

\textsuperscript{766} See sources cited supra note 269.

\textsuperscript{767} See BEST PRACTICES, supra note 154.
adhesionary contractual terms such as confession of judgment and mandatory arbitration clauses. Prohibiting such clauses seems fair because consumers have no real ability to bargain around them. Fifth, to prevent the exploitation of consumers who desperately need cash, Congress should follow several states that prohibit lenders from conditioning the issuance of a loan on the provision of collateral or a co-

768. Montana prohibits the following provisions in payday loan agreements:
   (a) a hold harmless clause;
   (b) a confession of judgment clause;
   (c) a waiver of the right to a jury trial, if applicable, in any action brought by or against a consumer;
   (d) a mandatory arbitration clause;
   (e) any assignment of or order for payment of wages or other compensation for services;
   (f) a provision in which the consumer agrees not to assert any claim or defense arising out of the contract; or
   (g) a waiver of any provision of this part.
MONT. CODE ANN. § 31-1-723(20)(a)-(g). Indiana bans clauses similar to Montana but also bans lenders from “[s]elling insurance of any kind in connection with the making or collecting of a small loans.” IND. CODE ANN. § 24-4.5-7-410(j)-(k). Florida has a shorter list of prohibited clauses. FLA. STAT. ANN. § 560.404(10) (West 2002).

769. See supra notes 241-42 and accompanying text; supra note 239 (showing that courts are upholding such clauses, and describing the unfortunate consequences to payday loan customers).

770. An adhesion contract is offered on a “take-it-or-leave-it” basis without offering the consumer a “realistic opportunity to bargain and under such conditions that the consumer cannot obtain the desired product or services except by acquiescing in the form contract.” Wheeler v. St. Joseph Hosp., 133 Cal. Rptr. 775, 783 (1977); Richard M. Alderman, Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform, 38 HOUS. L. REV. 1237, 1247 (2001) (“These [arbitration] contracts of adhesion bear little resemblance to the voluntary agreement envisioned when one thinks of ‘consent.’”) (footnote omitted). David S. Schwartz, of the American Civil Liberties Union, commented as follows:

Routine enforcement of pre-dispute arbitration clauses raises problems about consent that arise in adhesion contracts generally. Courts repeatedly pay lip service to the idea that arbitration “is a matter of consent, not coercion” and that what the courts are “rigorously” enforcing are “agreements” or “bargain[s]” to arbitrate. But if an arbitration clause has been inserted in a contract of adhesion on a ‘take-it-or-leave-it’ basis, it is difficult to characterize it as the product of “consent,” “agreement” or “bargaining.”

signatory. Finally, Congress should follow a few states that afford consumers a private right of action with remedies intended to motivate payday lenders to comply with the payday lending statute.

CONCLUSION

In various jurisdictions, lawmakers and state regulators, increasingly aware of the need to further regulate the payday loan industry, rely on state laws that antedate payday loans. These same persons enact, or attempt to enact, state laws to deal with abusive payday lending practices. While payday lending is expressly authorized in twenty-seven jurisdictions, it is illegal in twenty-one jurisdictions as a result of usury laws. In states that authorize, or merely permit payday lending due to the absence of usury laws, payday lenders may legally charge fees tantamount to triple-digit interest rates. Most of the states that authorize payday lending set limits on the size of the loan, the length of the loan period, and the interest rate/fee for the loan. The laws in these states, however,

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771. ARIZ. REV. STAT. ANN. § 6-1259(B)(9) (West 2001) (stating that a lender cannot “require a customer to provide security for the transaction, other than the presented check, or require the customer to provide a guaranty from another person”); FLA. STAT. ANN. § 560.404(9); HAW. REV. STAT. § 480F-4(b), (f) (2001); IND. CODE ANN. § 24-4.5-7-403 (“A small loan may not be secured by personal property other than a check or electronic debit.”); KY. REV. STAT. ANN. § 368.100(9) (Michie 2002); LA. REV. STAT. ANN. § 9:3578.6(b) (West 2002) (stating that lenders cannot “require for use as security any check issued pursuant to the federal Social Security Act”); MONT. CODE ANN. § 31-1-723(11), (16) (prohibiting a lender from “using or attempting to use the check provided by the consumer in a deferred deposit loan as security for purposes of any state or federal law” or from “accepting any collateral for a deferred deposit loan”); N.D. CENT. CODE § 13-08-12(1)(f) (2001) (“No property, titles to any property, or mortgages may be received or held directly or indirectly by the licensee as a condition of a deferred presentment service transaction or as a method of collection on a defaulted deferred presentment service transaction without proper civil process.”); R.I. GEN. LAWS § 19-14.4-5.1(b) (2001) (“The written agreement shall not permit the check cashier to accept collateral.”); TENN. CODE ANN. § 45-17-112(l) (2000) (“[N]o licensee shall require a customer to provide security for the transaction or require the customer to provide a guaranty from another person.”).

772. For instance, in Montana, payday lenders who violate the payday lending statute are “liable to the consumer for actual and consequential damages, plus statutory damages of $1,000 for each violation, plus costs and attorney fees.” MONT. CODE ANN. § 31-1-724(3). Injured customers can also bring class actions and may seek injunctive relief plus any other available legal or equitable remedies. Id. § 31-1-724(4)-(5).
amount to a poor patchwork solution due to the gross disparity between the highest and lowest permissible APRs. Moreover, while many payday loan statutes prohibit or limit rollovers, most statutes remain silent about many abusive payday lending practices, including the collection of treble damages from debtors, the prosecution of debtors for passing bad checks, and the issuance of serial loans by multiple lenders. Due to the legislative silence about these practices in states, the civil and criminal justice systems’ interpretation of general laws provide the primary method for determining whether payday lenders violate state law and whether punitive or criminal sanctions apply to their actions. Such reliance results in appalling consequences for many defaulting debtors because some judges, prosecutors, and litigators erroneously conclude that these consumers deserve punitive and criminal sanctions.

State payday loan statutes, and laws that pre-date the statutes, have, thus far, proven largely inadequate to fully protect consumers. Payday lenders devise, and continue to employ, sham transactions to circumvent usury and other consumer protection laws. Usury statutes should provide the first layer of protection against unconscionable payday loans, but payday lenders skirt these laws by fabricating transactions that purport to sell services or products and by drafting transactions that remove the loan from the purview of the state law.

Although the abuses of the payday lending industry are sufficient in themselves to compel state regulation, they extend beyond the bare terms of each loan transaction. As the Ohio Survey disturbingly reveals, these abuses begin with denying consumers access to information essential to informed decision-making—an abuse extending even to the deliberate concealment of payday loan terms—and extend to falsely representing to the consumer that he or she may rescind a payday loan at no cost. Payday lenders also employ disreputable, and sometimes illegal, practices such as obtaining treble damages from debtors in default, pursuing bad-check prosecution against them, and using rent-a-bank to charge fees in excess of usury laws and payday loan statutes. In fact, unscrupulous payday lenders have filed criminal complaints against their customers, and successfully persuaded district attorneys to prosecute them for writing bad checks. In almost every case, these prosecutions represent an inappropriate perversion of the check fraud statutes. Despite this perversion,
the prosecutions frequently serve as a viable collection tool for payday lenders. Accordingly, state-based regulations against the industry have proven as effective as sealing a leak on a rotten garden hose: Every time one leak is plugged, another appears!

The inability or unwillingness of the various states to effectively deal with payday loan abuses and the increasing use of rent-a-bank to circumvent state laws, demonstrates that the federal government must act now to enact comprehensive regulations dealing with the payday lending industry. First, to fully protect the consumer, new federal laws need to mandate that payday lenders include full disclosure of all loan terms with each transaction. These laws must also grant consumers the right to rescind the loan within three days of consummation. A three-day rescission period will ensure consumers a fair opportunity to make an informed decision. Second, the regulations should establish a national usury law preventing the exorbitant APRs currently garnered by payday lenders. Third, since payday loan customers are among the most financially vulnerable members of our society, Congress should require payday lenders to make a fair inquiry into each borrower's capacity to repay the loan before extending credit. Fourth, federal law should place a strict limitation on the ability of payday lenders to extend, renew, or refinance a payday loan, and mandate further that a portion of every renewal fee be used to reduce the borrower’s principle obligation.

Finally, payday lenders must be prohibited from taking any punitive action against their customers. The purpose of treble damage remedies is to deter willful or wanton misconduct; a payday loan customer's inability to repay a debt is seldom willful, and in any event is no more egregious than the failure of other consumers to pay a credit card or auto loan on time. Many states already preclude the criminal conviction of payday loan borrowers. Federal regulation must work to ensure that this rule prevails in all jurisdictions, not only to ensure due process for all, but to prevent payday lenders from coercing payment through the idle threat of criminal prosecution. Admittedly, payday loans frequently involve conduct that should be considered criminal, but it is the conduct of the lender, not the consumer, that warrants this conclusion. Accordingly, federal law should impose strict penalties on those lenders that refuse to comply with the
proposed regulations.

It may be, as payday lenders claim, that deferred deposit transactions constitute a necessary and desired form of consumer credit. Current laws, however, provide far too many opportunities for abuse by lenders, and do not afford payday loan customers the same consumer protections enjoyed by customers of traditional credit services. Consumers forced into these transactions already suffer financial distress disproportionate to the rest of the general public. These borrowers should not be forced to resort to credit sources that compound their economic hardship. Accordingly, Congress should act to stringently regulate the payday lending industry as an important step in equalizing consumer protection laws for all consumers, even if true equal credit opportunity remains elusive.
APPENDIX

Table 1: Initial Loan Information

<table>
<thead>
<tr>
<th>Payday Lender</th>
<th>Clerk Refused to Provide Application</th>
<th>Fees Posted</th>
<th>Loan Terms Conspicuously Posted</th>
<th>Brochures/ Pamphlets</th>
<th>Posted Fees Lacked APR Disclosure</th>
<th>Repeat Customer Reward Program</th>
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</thead>
<tbody>
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</table>

Percentage: 68% 86% 14% 27% 73% 18%

* Surveyors could not confirm the use of reward programs by other lenders because the Ohio Survey did not involve multiple loans with each lender. Therefore, information relating to repeat customer incentive programs was not independently verified.
Table 2: Information-Gathering Payday Loan Disclosures

<table>
<thead>
<tr>
<th>Payday Lender</th>
<th>Loan Fee Per $50</th>
<th>ORAL APR DISCLOSURES</th>
<th>DEFAULT ACTIONS</th>
</tr>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Denied Existence of APR</td>
<td>Clerk Claimed No Knowledge</td>
</tr>
<tr>
<td>1</td>
<td>$7.50</td>
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<td>$7.50</td>
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</tbody>
</table>

Percentage: 100% 32% 18% 14% 5% 32% 41%

* NSF-Not Sufficient Funds
# Payday lender indicated that while it would not report a loan default to a credit bureau, it would harass borrower.
## Table 3: Payday Loan Contract Consummation

<table>
<thead>
<tr>
<th>Payday Lender</th>
<th>CFSA Member</th>
<th>Clerk Claimed No Knowledge</th>
<th>Clerk Denied Existence</th>
<th>Clerk Evasive</th>
<th>Clerk Represented APR As Finance Charge</th>
<th>APR Properly Disclosed</th>
<th>Application Contained Terms</th>
<th>Binding Arbitration of Disputes Arising from Loan</th>
<th>Obtained Application Copy</th>
<th>Lender Had Knowledge of Preexisting Loan</th>
<th>Federal APR Disclosed</th>
<th>State APR Disclosed</th>
<th>TILA Cost of Credit Disclosed</th>
<th>Clerk Provided Copy of Executed Contract Without Solicitation</th>
<th>Borrower Precluded from Taking Contract Before Signing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
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* First lender approached.
# Lender did not use Tele-Track.
** Arbitration required for all disputes arising among the lender, borrower, and third parties.

Percentage: 64% 23% 9% 9% 9% 41% 86% 41% 18% 68% 100% 86% 100% 86% 77%
Table 4: Payday Loan Contract Rescission Stage

<table>
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<tr>
<th>Payday Lender</th>
<th>LOAN RESCISSION PROCEDURES</th>
<th>LOAN DEFAULT CONTINGENCIES*</th>
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Percentage: 36% 14% 5% 55% 27% 5% 9% 32%

* Testers in Ohio Survey did not default on any loans. It is therefore unknown whether other lenders would have allowed rollovers, threatened prosecution, or sought treble damages.