2008

Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences

Mary B. Spector
Southern Methodist University, Dedman School of Law

TAMING THE BEAST: PAYDAY LOANS, REGULATORY EFFORTS, AND UNINTENDED CONSEQUENCES

*Mary Spector**

INTRODUCTION

On his honeymoon, Kevin Woodall learned that his employer had filed for bankruptcy.[1] Strapped for cash and saddled with a poor credit history, Kevin wrote a check for $500—more than he had in the bank at that time.[2] He received $350 back; the extra $150 represented a $30 fee for each $100 he borrowed.[3] At the end of two weeks, he did not have enough to repay the loan, but he did have enough to cover the $150 fee, so he paid to renew the loan for an additional two weeks.[4] After a year, he had paid approximately $4,000 in fees and still owed the $350 principal.[5]

Woodall engaged in a transaction that millions of Americans use each year: the payday loan. Also known as a payday advance, a deferred presentment transaction, or a deferred deposit advance, the payday loan is a small-dollar, short-term, unsecured loan that borrowers promise to repay within a matter of weeks, often out of their next paycheck. It is usually priced as a fixed-dollar fee, which represents the finance charge[6] to the borrower. When the cost of the credit is expressed as an annual percentage rate (APR), that APR is often in

---

* Associate Professor of Law and Co-Director, SMU Civil Clinic, Southern Methodist University Dedman School of Law; J.D. 1986, Benjamin N. Cardozo School of Law; B.A. 1979, Simmons College. The author wishes to thank the SMU Dedman School of Law for contributing to this Article by providing financial support, members of the library and support staff for their technical support and assistance, and Katherine Stein, James Hunnicut, and Amanda Burcham of the SMU Dedman School of Law classes of 2006, 2007, and 2008, respectively, for their diligent and thorough research assistance. Thanks also go to members of the faculty for their interest in the subject, particularly Professor Beth Thornburg, who provided unending encouragement, and Professors Julie Forrester and Rose Cuison Villazor.

1. Earl Golz, *High Interest in Payday Loans; Consumer Groups Calling for Regulation to Cap Rate*, AUSTIN AM. STATESMAN, Mar. 28, 1999, at F1.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. Federal law defines a finance charge as "the cost of consumer credit as a dollar amount." Regulation Z, 12 C.F.R. § 226.4(a) (2005).

the triple digits. For example, a consumer wishing to borrow $200 for fourteen days at a charge of $15 per $100 will write a check for $230. The APR for this transaction is 390%,[7] although one study found APRs on similar transactions to be as high as 910%.[8] APRs may be even higher for consumers in the United Kingdom, where an internet provider advertises loans of £80 to be repaid twenty-eight days later in the amount of £100, an APR of 1,734.1%.[9]

How can that be if state usury caps apply? Even though small loan laws prohibit that kind of charge for credit, effective regulation of the payday loan has been elusive. Much like the mythical beast Hydra,[10] the payday loan is resistant to attempts to tame it. Regulators at state and federal levels have attempted to control the beast, but, just as their attempts appear to be working, the industry has emerged once again with a new face. Its most recent face is the credit service organization (CSO), a product of a legislative scheme that Congress and more than two-thirds of the states enacted to promote legitimate efforts to encourage consumer credit responsibility.[11] Ironically, most CSO legislation was drafted to deter deceptive practices by entities who claimed to "clean up" the credit of overextended consumers and to encourage legitimate services to provide the reliable and truthful

---

7. GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, CREDIT RESEARCH CTR., PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CUSTOMER DEMAND 3 (2001), http://www.cfsa.net/downloads/analysis_customer_demand.pdf. In a variation of this transaction, the lender may advance the principal amount of the loan in exchange for the purchase of an advertisement in a catalog. The advertising rate schedule is calculated in much the same way as the fee for a basic payday loan. If, at the end of the loan period, the consumer wishes to extend the loan, she can purchase an additional advertisement or coupon for an additional fee. *See* Press Release, Office of the Attorney General, Texas, Cornyn Files Suit in Austin and McAllen Against "Payday" Lenders (May 12, 1999), *available at* http://www.oag.state.tx.us/newspubs/newsarchive/1999/19990512paydayloans.htm [hereinafter Cornyn Press Release].

8. JEAN ANN FOX & EDMUND MIERZWINSKI, CONSUMER FED'N OF AM. & U.S. PUB. INTEREST RESEARCH GROUP, RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 4 (Nov. 2001), http://www.consumerfed.org/pdfs/paydayreport.pdf.

9. Payday Loan Co. Home Page, http://www.paydayloan.co.uk/homeset.htm (follow "Our Charges" hyperlink) (last visited Feb. 15, 2008). While many of the features of payday lending apply equally to lending over the internet, internet lending presents its own unique problems and is beyond the scope of this Article.

10. EDITH HAMILTON, MYTHOLOGY: TIMELESS TALES OF GODS AND HEROES 171 (1969). Hydra was the mythical swamp beast of Lerna, a creature with nine heads, one of which was immortal. As penance for the murder of his wife and children, Hercules was sent to perform twelve labors, the second of which was to kill Hydra. The job was difficult; each time Hercules severed one of Hydra's heads, two more grew in its place. Eventually, with the help of his nephew Iolaus, Hercules devised a plan. One after the other, Hercules severed each of Hydra's eight mortal heads and burned the stump with a torch to prevent others from replacing it. Last of all, Hercules severed the immortal head, seared the neck, and buried it under a "great rock" to conquer the beast. *Id.*

11. *See infra* notes 165–198 and accompanying text.

information necessary to make informed decisions about credit.[12] Most states, however, have expanded the definition of a CSO to include not only entities that assist consumers in improving their credit history or rating, but also those that assist or advise consumers in obtaining credit itself.[13] Because CSOs are not lenders, they operate outside of the supervision and rate regulation that most states impose upon consumer lenders. Accordingly, the payday lender's rebirth as a CSO allows it to avoid rate regulation by "assisting" the consumer in obtaining high-cost credit,[14] conduct which is the very antithesis of what many consumer advocates had hoped to accomplish with such legislation.[15]

Payday lenders' use of the CSO designation is a cause for concern, not only because it demonstrates the industry's resilience and resistance to piecemeal regulation, but also because their strict compliance with the technical aspects of the CSO model appears to have left courts little room to exercise their traditional role in protecting consumers from transactions designed to avoid rate regulation. This unintended consequence is particularly troublesome when examined against the broader issue of high-cost credit[16] and its strong potential for predatory lending.[17]

This Article examines the payday loan phenomenon, reviews state and federal attempts to regulate it, and explores its most recent appearance under the protection of state CSO laws designed to protect

---

12. *See id.*

13. *See* TEX. FIN. CODE ANN. § 393.001(3) (Vernon 2006) (defining a CSO as "a person who provides, or represents that the person can or will provide, for the payment of valuable consideration any of the following services with respect to the extension of consumer credit by others: (A) improving a consumer's credit history or rating; (B) obtaining an extension of consumer credit . . . ."); *see infra* notes 166–167 and accompanying text.

14. *See infra* notes 165–169 and accompanying text.

15. *See infra* notes 165–198 and accompanying text.

16. *See* CHRISTOPHER L. PETERSON, TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH-COST CREDIT MARKET (2004).

17. *See, e.g.*, Julia Patterson Forrester, *Still Mortgaging the American Dream: Predatory Lending, Preemption, and Federally Supported Lenders*, 74 U. CIN. L. REV. 1303, 1359–70 (2006). While predatory lending is most often associated with mortgage lending practices, it is also present in the small loan market. A 2006 Department of Defense report characterized predatory practices in the non-mortgage market as including one or more of the following characteristics:

> High interest rates and fees; little or no responsible underwriting; loan flipping or repeat renewals that ensure profit without significantly paying down principal; loan packing with high cost ancillary products whose cost is not included in computing interest rates; a loan structure or terms that transform these loans into the equivalent of highly secured transactions; fraud or deception; waiver of meaningful legal redress; or operation outside of state usury or small loan protection law or regulation.

U.S. DEPT. OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 2–3 (Aug. 9, 2006), http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf [hereinafter DoD REPORT].

overextended consumers. Part II examines the transaction and the parties involved: what is a payday loan; who makes them; and who are the customers?[18] Part III describes state and federal attempts to regulate payday lending.[19] Part IV explores states' attempts to protect credit-seeking consumers with laws designed to regulate CSOs and the payday loan's emergence between the lines of this regulation.[20] Part V concludes with some thoughts on approaches to tame the Hydra once and for all.[21]

II. THE PAYDAY LOAN

This Part provides some background. Section A briefly looks at the growth of the payday loan industry.[22] Sections B and C examine more closely the typical payday loan customer[23] and lender.[24]

A. *Growth of the Industry*

Nationwide, payday loans were virtually unknown in 1990. They developed much like traditional lending devices did, emerging between the gaps in usury laws that set ceilings on the rates charged for loans. Just as medieval lenders structured transactions to avoid church law prohibitions,[25] payday lenders of the 1990s argued that their transactions were not loans. They maintained, among other things, that the payday advance is a form of check-cashing service[26] or sale of a check. Payday lenders marketed their services as more affordable and, therefore, more desirable than late charges on credit cards, bank charges for insufficient funds, or utility reconnect fees.[27] They also maintained that they were not required to register under state small loan laws and, thus, were not bound by state usury caps.[28] As regulators and state legislators scrambled to catch up with the reports of high-cost credit, the industry grew.

---

18. *See infra* notes 22–60 and accompanying text.
19. *See infra* notes 61–162 and accompanying text.
20. *See infra* notes 163–236 and accompanying text.
21. *See infra* notes 237–248 and accompanying text
22. *See infra* notes 25–33 and accompanying text.
23. *See infra* notes 34–48 and accompanying text.
24. *See infra* notes 49–60 and accompanying text.
25. *See* SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 69–71 (4th ed. 2005).
26. *See, e.g.*, Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375, 1380–81 (S.D. Ga. 2000); *see infra* notes 91–92 and accompanying text.
27. Cmty. Fin. Servs. Ass'n of Am., Payday Advance: Fact vs. Fiction, http://www.cfsa.net/fact_vs_fiction.html (last visited Feb. 15, 2008).
28. *See infra* notes 99–101 and accompanying text.

By 1999, payday loans were available at more than 10,000 outlets across the country.[29] That number reportedly doubled by May 2005, when payday loan stores outnumbered McDonald's restaurants nationwide.[30] A study published jointly by the Consumer Federation of America and the U.S. Public Interest Research Group (US PIRG) reported that, by the end of 2001, "12,000 to 14,000 payday loan stores [made] 100 or more loans per month, with another 8–10,000 smaller volume operators."[31] That same year, Fannie Mae estimated that stores made as many as 69 million payday loan transactions a year, with a volume of $13.8 billion, producing up to $2.2 billion in fees.[32] By 2005, the industry's volume had grown to $40 billion.[33]

B. Payday Loan Customers

Studies of payday loan customers conducted by industry representatives, state and federal agencies, and consumer advocacy groups show, not surprisingly, different results. Although an industry-funded survey found that over half of the borrowers had family incomes between $25,000 and $50,000,[34] other research suggested that the majority of payday borrowers fall at the lower end of the range, with another 23% reporting incomes of less than $25,000.[35] The same survey described the payday loan customer as a young parent (under the age of forty-five) and likely female; 90% have a high school diploma, and 56% have at least some college education.[36] A 2006 report issued by the Department of Defense (the "DoD Report") suggests that payday borrowers are generally young, financially inexperienced, steady job-holders with little saved.[37]

---

29. ELLIEHAUSEN & LAWRENCE, *supra* note 7, at 2.

30. *See 60 Minutes II: Paying More for Payday Loans* (CBS television broadcast May 18, 2005) (transcript available at http://www.cbsnews.com/stories/2005/05/16/60II/main695461.shtml).

31. *See* FOX & MIERZWINSKI, *supra* note 8, at 4.

32. JAMES H. CARR & JENNY SCHUETZ, FANNIE MAE FOUND., FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 10 (Aug. 2001), http://www.fanniemaefoundation.org/programs/financial.pdf.

33. DOD REPORT, *supra* note 17, at 11.

34. *See* NAT'L ENDOWMENT FOR FIN. EDUC. & CONSUMER FED'N OF AM., THE DEBT CYCLE: USING PAYDAY LOANS TO MAKE ENDS MEET 13 (Feb. 27–28, 2002) [hereinafter THE DEBT CYCLE]; OFFICE OF STATE AUDITOR CLAIRE MCCASKILL, DIV. OF FIN. & REGULATION OF INSTANT LOAN INDUS., MO., PERFORMANCE AUDIT 3 (May 9, 2001), *available at* http://www.auditor.mo.gov/press/2001-36.pdf.

35. ELLIEHAUSEN & LAWRENCE, *supra* note 7, at 28–29.

36. *See* THE DEBT CYCLE, *supra* note 34, at 12–13 (finding that 62% of payday loan customers are women with children under the age of eighteen living at home).

37. DOD REPORT, *supra* note 17, at 4.

One study showed that payday lenders are more heavily concentrated in lower-income African American neighborhoods than in white neighborhoods with similar income levels and suggested racial motivations in the industry's growth.[38] Concentrations of lenders proximate to domestic military bases signaled alarm among high-level military personnel.[39] Indeed, studies showed that service members and their families were three times more likely to secure payday loans than civilian families[40] and that payday loans contributed significantly to credit problems that undermined "troop readiness, morale, and quality of life."[41] One of the most troubling aspects of the DoD Report is that credit problems, in general, account for 80% of security clearance revocations and denials in one branch of the service.[42]

Regardless of the borrower's race or occupation, the payday borrower's ability to repay the loan is only minimally considered. Instead, only a current pay stub or other proof of regular income is needed. Because credit reports are generally not required as a condition of the loan, borrowers with limited ability to repay or an otherwise poor credit history turn to the payday loan, because other sources of credit are unavailable to them. One industry study reported that 15.4% of all payday borrowers have filed for bankruptcy—compared with 3.7% of the general population—and only 41.7% own their homes—compared with 66.3% of all adults.[43]

In short, the typical payday borrower does not have access to traditional credit outlets and often seeks a short-term loan because of a financial emergency, such as car repairs or medical expenses. But such emergencies are rarely short-term, and a single payday loan is

38. URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, RACE MATTERS: THE CONCENTRATION OF PAYDAY LENDERS IN AFRICAN-AMERICAN NEIGHBORHOODS IN NORTH CAROLINA 2 (Mar. 22, 2005). *But cf.* DIEGO SALTES, CMTY. FIN. SRVS. ASS'N OF AM., A LOOK AT "RACE MATTERS: THE CONCENTRATION OF PAYDAY LENDERS IN AFRICAN-AMERICAN NEIGHBORHOODS IN NORTH CAROLINA" 1 (Sept. 2005) (criticizing King's data collection method, hypothesis, and regression analysis). This issue of clustering high-cost lending in neighborhoods based on their racial composition is not unique to the twenty-first century. *See infra* note 89 and accompanying text.

39. Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 OHIO ST. L.J. 653, 690 (2005). The Graves and Peterson article provided much of the support for the DoD Report. *See* DOD REPORT, *supra* note 17, at 10–11, 45.

40. OZLEM TANIK, CTR. FOR RESPONSIBLE LENDING, PAYDAY LENDERS TARGET THE MILITARY: EVIDENCE LIES IN INDUSTRY'S OWN DATA 1 (Sept. 29, 2005), http://www.responsiblelending.org/pdfs/ip011-PaydayMilitary-0905.pdf. In October 2006, Congress acted, capping the interest rates that payday lenders may charge military personnel and their families. *See infra* note 129 and accompanying text.

41. DOD REPORT, *supra* note 17, at 45.

42. *Id.* at 39.

43. ELLIEHAUSEN & LAWRENCE, *supra* note 7, at 42, 46.

rarely the solution. One study found that consumers need at least ninety days to retain firm footing, not the two weeks that is generally the length of the payday loan.[44] This results in the borrower engaging in multiple loans or rollovers to extend the life of the loan. A study of Oklahoma payday lending practices found that the average borrower engaged in 9.4 loans per year.[45] Indeed, data suggest that 90% of payday loans are made to borrowers who have engaged in more than five payday transactions in the previous twelve months and more than 60% are made to borrowers with more than twelve transactions in the previous year.[46] Additionally, 38% of borrowers had more than ten same-lender loans, and 14% had more than nineteen.[47] Multiple transactions result in the average payday borrower paying $793 in principal and interest to repay a $325 loan, creating a debt-cycle that is difficult to break.[48] The payday loan customer is, therefore, often the customer of the credit repair firm and other CSOs, which often market themselves as useful in assisting consumers emerging from debt, making their combination even more treacherous for the consumer.

C. Who Are the Lenders?

Payday lenders also routinely provide other services, such as check cashing and pawn shop services, prepaid phone cards, and money wiring. Together with title loan and rent-to-own transactions, these services form a market sector known as the "alternative financial services industry," or what John P. Caskey calls "fringe banking."[49]

Two of the largest such lenders are publicly traded companies headquartered in Texas. ACE Cash Express, Inc., headquartered in Irving, Texas, was founded in 1968 and operates a network of more than 1,500 stores in thirty-eight states and the District of Columbia.[50] Cash America International, Inc., headquartered in Fort Worth, Texas, was

---

44. URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, FINANCIAL QUICKSAND: PAYDAY LENDING SINKS BORROWERS IN DEBT WITH $4.2 BILLION IN PREDATORY FEES EVERY YEAR 9 (Nov. 30, 2006), http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf.

45. VERITEC SOLUTIONS LLC, OKLAHOMA TRENDS IN DEFERRED DEPOSIT LENDING: OKLAHOMA DEFERRED DEPOSIT PROGRAM 8 (May 2007), http://www.veritecs.com/OK_Trends_05_2007.pdf.

46. KING ET AL., *supra* note 44, at 6.

47. FOX & MIERZWINSKI, *supra* note 8, at 9.

48. KING ET AL., *supra* note 44, at 2.

49. Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 591 (2000) (citing JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 1 (1994) (coining the term "fringe banks" to describe check-cashing businesses and pawnshops)).

50. ACE Cash Express, Company Info, http://www.acecashexpress.com/ci_main.php (last visited Feb. 15, 2008).

founded in 1983 and is publicly traded on the New York Stock Exchange. It describes itself as "a diversified specialty finance company serving the needs of the underbanked segment of the population" and as "the market leader in secured non-recourse lending."[51] Cash America operates almost 500 pawnshops worldwide, with locations in the United States, the United Kingdom, and Sweden.[52] Other companies include Dollar Financial Corp., which operates nearly 800 outlets under the "Money Mart" and "Loan Mart" names in the United States and Canada and nearly 200 outlets in the United Kingdom under the name "Money Shop."[53] There are hundreds of others operating under names such as Red-D-Cash, Money Central, National Check Cashers, EZ Loan, and Advance America.[54]

In 1999, payday lenders established a trade association known as the Community Financial Services Association (CFSA), which claims membership of more than 150 companies representing about 60% of the industry.[55] The CFSA is actively engaged in legislative work in all fifty states and funded a 2001 study of customer demand published by the McDonough School of Business at Georgetown University.[56] The primary focus of the organization's legislative work has been the promotion of industry-friendly state statutes.[57] In 2000, it promulgated a set of "Best Practices," which it requires its members to display prominently in retail outlets.[58] Compliance is not mandatory, but the CFSA maintains that member compliance is high and that the Best Practices serve as evidence of its members' responsible approach to their business.[59] In February 2007, the CFSA announced a $10 million advertising campaign describing changes to their Best Practices.

51. Cash America, Corporate Information, http://www.cashamerica.com/corp.html (last visited Feb. 15, 2008).

52. *See* Cash America, Corporate History, http://www.cashamerica.com/corp_history.html (last visited Feb. 15, 2008).

53. Dollar Financial Corp., Firmly Planted, http://www.dfg.com/markets.asp (last visited Feb. 15, 2008).

54. Companies operating outside the United States use similar names, such as Cash Doctors in Australia and Mr. Payday in Canada. *See* Cash Doctors Home Page, http://www.cashdoctors.com.au (last visited Feb. 15, 2008); Mr. Payday Home Page, http://www.mrpayday.ca (last visited Feb. 15, 2008). *See also* Christopher Conkey, *Payday Lenders Strike a Defensive Pose: Voluntary Limits on Advertising, New Repayment Options Aim to Ward Off Fresh Regulations*, WALL ST. J., Feb. 21, 2007, at A8.

55. *See* CFSA, About CFSA, http://www.cfsa.net/about_cfsa.html (last visited Feb. 15, 2008).

56. ELLIEHAUSEN & LAWRENCE, *supra* note 7, at iii.

57. CFSA, Payday Advance State Legislation, http://www.cfsa.net/state_legislation.html (last visited Feb. 15, 2008) ("A Regulated Alternative to Unregulated Internet Lenders").

58. CFSA, Best Practices for the Payday Advance Industry, http://www.cfsa.net/industry_best_practices.html (last visited Feb. 15, 2008).

59. *See* CFSA, About CFSA, *supra* note 55.

Among those changes is an annual offer of an optional extended payment plan to borrowers who are unable to pay off their loans.[60]

III. Regulation of Payday Lending

This Part reviews both historical and modern attempts to regulate payday lending. First, Section A explores the origins of lending regulations and their metamorphosis since antiquity.[61] Sections B and C survey state attempts to regulate—or even prohibit—payday loans.[62] Section D describes federal attempts to regulate payday lending.[63]

A. Historical Background

Efforts to regulate lending go back thousands of years.[64] Many have their origins in prevailing religious traditions.[65] Although records show maximum rates of interest and violations of those rates during both the Babylonian and Roman periods,[66] it is biblical prohibitions against usury that form the core of not only modern lending practices, but also the moral and ethical tone often employed in connection with those who lend money to others. Exodus, Leviticus, and Deuteronomy each contain prohibitions against usury, a term that was used to describe any kind of charge for the use of money.[67] However, by the twelfth century C.E., Jews developed an intricate system of borrowing and lending money among themselves that was consistent with the biblical injunctions.[68] As a result, when Jews lent money to non-Jews, they appeared to do so in a manner that complied with the requirements of their religious tradition by, for example, structuring transactions as partnerships in which the lender provided the capital for the partnership and received a fixed sum from the borrower as compensation.[69]

---

60. Conkey, *supra* note 54, at A8.

61. *See infra* notes 64–105 and accompanying text.

62. *See infra* notes 106–128 and accompanying text.

63. *See infra* notes 129–162 and accompanying text.

64. *See* Homer & Sylla, *supra* note 25, at 1–65 (discussing how ancient efforts to regulate lending activities date as far back as 3000 B.C.E.).

65. *See id.* at 67–79; *see also* Wayne A.M. Visser & Alastair MacIntosh, *A Short Review of the Historical Critique of Usury*, 8 Accounting, Bus. & Fin. History 175, 175–89 (1998), *available at* http://www.alastairmcintosh.com/articles/1998_usury.htm (describing how Buddhism, Christianity, Hinduism, Islam, and Judaism all embrace prohibitions of usury).

66. *See* Homer & Sylla, *supra* note 25, at 25–64.

67. *See Exod.* 22:25; *Lev.* 25:36–37; *Deut.* 23:19–20; Homer & Sylla, *supra* note 25, at 71.

68. The Code of Maimonides, Book XIII: The Book of Civil Laws 85–87 (Jacob J. Rabinowitz trans., Yale Univ. Press 1949).

69. This method is still used today. *See* Rabbi Yisroel Reisman, The Laws of Ribbis 378–424 (1995) (explaining the practice and providing sample forms).

In another type of transaction designed to avoid the strict application of usury laws, the English landowner or "freeholder" in need of cash could transfer a possessory interest in a portion of an estate to an investor for a fixed period of time, usually a term of years.[70] The investor, or tenant, would pay the freeholder a lump sum at the commencement of the period in exchange for the right to possess a defined parcel of land.[71] Often involving the payment of large sums, the transaction enabled the parties to circumvent church prohibitions against usury by allowing the investor to recover the original payment from income generated by the land in his possession during the term.[72] These transactions are believed to be at the core of the modern land lease and mortgage.[73] They also suggest a basis for the use of a long-term lease to obtain financing in modern complex real estate transactions.[74]

By the sixteenth century, English law and Roman Catholic doctrine permitted interest charges and limited the meaning of usury to "excessive" interest charges for the use of money.[75] The first statutory caps were low, between 6% and 12%, a structure that remains common today.[76] Within this structure, however, opportunities existed for lenders to develop financing designed to avoid the use of money, yet, at the same time, to provide the investor with a rate of return higher than the statutory interest cap.

---

70. The existence of a predetermined time period, regardless of length, defines a tenancy for years. *See* RESTATEMENT (SECOND) OF PROPERTY: LANDLORD AND TENANT § 1.4 cmt. b (1977).

71. *See* THEODORE F.T. PLUCKNETT, A CONCISE HISTORY OF THE COMMON LAW 573 (5th ed. 1956). Professor Plucknett's description of these early termors as "grasping money-lender[s]" who entered into "speculative arrangement[s]" that were "calculated to evade the law against usury" and designed to deprive landowners of their family lands serves as one source of the Restatement's description of the historical background of landlord and tenant law. *Id.*; *accord* RESTATEMENT (SECOND) OF PROPERTY: LANDLORD AND TENANT 2 (1977). Interestingly, in light of his value-laden language, Professor Plucknett failed to mention historical evidence that many of the early termors were Jews. Prior to the expulsion of the Jews from England in 1290, these transactions were enforceable in a special Court of the Exchequer of the Jews and are believed to be a source of modern financing documents. *See* JACOB J. RABINOWITZ, JEWISH LAW: ITS INFLUENCE ON THE DEVELOPMENT OF LEGAL INSTITUTIONS 250–72 (1956); Judith A. Shapiro, Note, *The Shetar's Effect on English Law—A Law of the Jews Becomes the Law of the Land*, 71 GEO L.J. 1179 (1983).

72. *See* W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW: VOLUME III 129 (3rd ed. 1923).

73. *See* PLUCKNETT, *supra* note 71, at 511–12; Mary Ann Glendon, *The Transformation of American Landlord-Tenant Law*, 23 B.C. L. REV. 503, 506 (1982) (describing the early lease as "a security device").

74. Marvin Milich, *The Real Estate Sale-Leaseback Transaction: A View Toward the 90s*, 21 REAL EST. L.J. 66, 66–67 (1992).

75. *See* HOMER & SYLLA, *supra* note 25, at 77–79.

76. TEX. CONST. art. XVI, § 16.

Courts played an integral role in the development of these practices. One way to avoid the use of money was to structure a transaction as a sale, rather than a loan, in which the seller charged the buyer a fee for the privilege of paying the sales price over time.[77] The fee charged to the buyer, known as the time-price differential, was not subject to usury caps that applied only to loans for the use of money.[78] Eventually this judge-made exception to the law of usury became widely codified and now appears in most states as a retail sale regulation of consumer transactions.[79] Even after codification, courts continued to scrutinize the substance of such transactions carefully and refused to enforce them unless a legitimate, bona fide sale existed.[80] Similarly, although courts held that lenders' charges for services other than the use of money[81] and legitimate payments to third-party brokers[82] fell outside of the usury rules, they also demonstrated a willingness to protect borrowers by peeling away the form of a transaction to ensure that its substance was legitimate.[83]

Judicial hostility to such practices is apparent in the language used to analyze the transactions. Their highly charged language includes a description of the lender as a "loan shark pest"[84] and of the transaction as being "infected with usury"[85] or characterized "by subterfuge and circumvention of one kind or another to present the color of legality."[86] Such language demonizing the lenders is consistent with a paradigm of the "ignorant borrower" one scholar used to describe

77. The case usually credited with first stating this proposition is *Floyer v. Edwards*, (1774) 98 Eng. Rep. 995 (K.B.). Its rule was recognized in the United States nearly ninety years later in *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1861). *See also* Kinerd v. Colonial Leasing Co., 800 S.W.2d 187, 190 (Tex. 1990) (affirming a usury verdict where the jury found the transaction structured as a sale was a "device for accomplishing a loan").

78. *See Floyer*, 98 Eng. Rep. 995.

79. *See, e.g.*, N.J. STAT. ANN. § 17:16C-1(l) (West 2007) (New Jersey Retail Installment Sales Act of 1960) (defining the time-price differential); *see also* JOHN A. SPANOGLE ET AL., CONSUMER LAW: CASES & MATERIALS (West 1991) (1979).

80. *See Kinerd*, 800 S.W.2d 187; Carper v. Kanawha Banking & Trust Co., 207 S.E.2d 897 (W. Va. Ct. App. 1974).

81. *See* Andrews v. Pond, 38 U.S. 65, 76 (1839) (labeling a fee charged an "exchange" will not remove the "taint of usury" if the parties' intent was to charge more than the permitted rate of interest).

82. *See* Mitchell v. Napier, 22 Tex. 123 (1858).

83. *See* Simpson v. Penn Discount Corp., 5 A.2d 796, 798 (Pa. 1939) (considering parol evidence in analyzing the transaction and finding it to be substantively usurious).

84. State *ex rel.* Embry v. Bynum, 9 So. 2d 134, 142 (Ala. 1942) (criminal prosecution for violation of usury laws).

85. State *ex rel.* Spillman v. Cent. Purchasing Co., 225 N.W. 46, 48 (Neb. 1929).

86. *Simpson*, 5 A.2d at 798.

courts' protection of borrowers from overreaching practices in the mortgage market.[87]

Notwithstanding courts' harsh penalties for such transactions, high-interest lending never disappeared; rather, it simply operated outside the bounds of the law. These attempts were not always successful, as demonstrated by nine cases involving a single lender during an eight-year period between 1911 and 1919.

At the heart of each case is a transaction that resembles the modern payday loan. The lender, Almon Cotton, operated several offices throughout Houston from his downtown central office.[88] Through local offices with "high sounding" names like the Dixie Loan Company, the Texas Loan Company, the Empire Loan Company, the New York Loan Company, and the Eagle Loan Company, Cotton employed a general manager and several "'outside men,' whose duty it was, among others, to advise the needy and helpless that they could always get money from one of Cotton's institutions."[89] The employees had "positive orders" to "buy salaries and wages."[90] In return, Cotton's employees took an assignment of salary and wages along with a power of attorney enabling them to collect directly from the debtor's employer.[91] If the borrower did not repay the loan, Cotton would exercise the assignment using the power of attorney executed at the time of the loan.[92] The effective interest rate offered to the borrowers appeared fairly uniform: "20 per cent. per month for whites and 30 per cent. per month to [African Americans]."[93]

---

87. Rashmi Dyal-Chand, *From Status to Contract: Evolving Paradigms for Regulating Consumer Credit*, 73 TENN. L. REV. 303, 304 (2006). Professor Dyal-Chand suggests that, historically and currently, this paradigm has protected borrowers' property rights in their homes and that, in the credit card market, it is being replaced by an "enlightened borrower" paradigm using contract rather than property rules, resulting in greater access to credit with less protection. *Id.* at 304–05.

88. Cotton v. Cooper, 209 S.W. 135, 136 (Tex. Comm'n App. 1919, judgm't adopted).

89. *Id.* at 136 (quoting from lower court decision).

90. *Id.* (internal quotation marks omitted).

91. *Id.*; *see also* Cotton v. Sanderson, 160 S.W. 658, 659 (Tex. Civ. App. 1913, writ dism'd); Cotton v. Thompson, 159 S.W. 455, 457 (Tex. Civ. App. 1913, no writ) (considering "sale" of $57.50 "out of . . . salary or wages").

92. *Cooper*, 209 S.W. at 136.

93. *Id.*; *accord Sanderson*, 160 S.W. at 659. The application of a specific rate dependent on the borrower's race appears to be no accident as the court described Cotton's businesses as appearing to be clustered "only where ignorant [African American] labor is abundant." *Cooper*, 209 S.W. at 135. The Commission of Appeals described the transactions more specifically:

> The borrower executed his assignment and power of attorney, we will say for $19.50, and was thereupon given $15 in cash. At the end of the month he was 'permitted' to collect his own salary and bring in the portion which he had pledged to the loan office. If he desired to retain the money he had borrowed, he did not pay the 30 per cent. interest and renew the obligation. Instead, he went through the formality of paying the

In almost all cases, Texas courts were hostile to Almon Cotton's practices. In five of the nine cases, borrowers obtained damages for the collection of usurious interest or conduct relating to the collection of the debts themselves.[94] In two of the nine cases, courts dismissed borrowers' claims for damages on technical grounds.[95] The remaining two cases involved satellite litigation arising from circumstances related to the collection of debts.[96] The 1919 decision of *Cotton v. Cooper*,[97] in which the court not only affirmed a finding of usury but also upheld an admittedly "disproportionate" award of exemplary damages, demonstrated the court's hostility to Cotton's practices:

> The record discloses that the "loan offices" controlled by defendant are conducted in utter disregard of private rights and the public good, and that the system has fastened itself upon many hundred employ[ee]s of various industries. In the city of Houston alone between 1,000 and 1,500 railroad employ[ee]s are on defendant's books. In the great majority of instances the borrowers are from the very ignorant class. Usurious transactions of the most extreme and aggravating type are cloaked and concealed by subterfuge in order to evade the penalties of the law. The powers of attorney executed by those dealing with defendant are as chains binding them to the system. The threat of the filing of these instruments and the consequent loss of employment is kept ever before them, driving them through fear into deeper slavery. In a word, the business is fraught with great evil, not only to the individual, but to the public as well.[98]

The practices employed by Almon Cotton were not limited to Texas. Similar transactions were met with similar hostility by other

---

> $19.50 in cash. He then executed a new obligation and assignment and received back $15 of the money paid by him.

Id. at 136.

94. *Cooper*, 209 S.W. at 138 (affirming judgment against Cotton for conduct in connection with attempts to collect debt arising from usurious loans); Cotton v. Barnes, 167 S.W. 756, 757 (Tex. Civ. App. 1914, writ dism'd) (affirming judgment against Cotton for double the amount of usurious interest and describing his agents as "parasites" and "vampires that fatten on the misfortunes of the poor"); *Sanderson*, 160 S.W. at 659 (affirming judgment against Cotton for statutory penalties for collecting usurious interest); *Thompson*, 159 S.W. 455 (same); Cotton v. Garza, 153 S.W. 412 (Tex. Civ. App. 1913, no writ) (same).

95. Cotton v. Beatty, 162 S.W. 1007, 1009 (Tex. Civ. App. 1913, writ dism'd) (reversing judgment against Cotton and remanding for determination of whether an illiterate borrower executed a valid release for valuable consideration); Garza v. Cotton, 120 S.W. 212 (Tex. Civ. App. 1909, writ dism'd) (affirming dismissal of suit seeking penalties for collection of usurious interest for failure to comply with venue rules).

96. Cotton v. Rea, 163 S.W. 2 (Tex. 1914) (injunction to restrain enforcement of a judgment in a previous suit involving the collection of a debt); McKneely v. Armstrong, 212 S.W. 175 (Tex. Civ. App. 1913, no writ) (suit by employee against employer for wages allegedly the subject of assignment to Cotton).

97. 209 S.W. 135.

98. *Id.* at 138.

states' courts.[99] For example, in a pair of consolidated cases, Kansas sought permanent and temporary injunctions preventing the defendants from (1) continuing to make loans at "usurious rates of interest ranging from 240 per cent. to 520 per cent." and (2) enforcing wage assignments executed in connection with them.[100] The court rejected the defendants' contention that the state had no power to intervene in their private contractual relationships:

> [I]t is perfectly obvious that for the hundreds of indigent debtors held in financial peonage by defendants the remedy supplied by law is pitifully inadequate; and the ruling in [*Pritchett v. Mitchell*] that the exaction of usury is a mere contractual matter of no concern to anybody but the parties themselves is imperatively in need of revision in the light of the complex social and economic conditions brought about by the industrial development in the half century since that doctrine was announced. The long-continued subjection of hundreds of indigent debtors to the usurious exactions of defendants by keeping them in fear of losing their jobs if they should have the temerity to assert the rights accorded them by the beneficent statutes of this commonwealth presents a situation which cannot be tolerated, and one which quite justifies the institution of this litigation by the state itself.[101]

By the turn of the twentieth century, the Russell Sage Foundation introduced its Uniform Small Loan Law to combat the sort of "great evil" described by the Texas court.[102] In 1916, it introduced a three-tiered approach to the regulation of small dollar consumer loans: (1) higher interest rates, as much as 30% to 40%, for loans of money under a certain amount; (2) regulated additional fees, charges, and interest charged by consumer lenders; and (3) state licensing of lenders permitted to charge higher interest rates.[103]

99. Capital Loan Co. v. Bell, 170 S.W. 570, 571 (Ark. 1914) (affirming an injunction preventing a creditor from enforcing wage assignments as being a "mere cloak to cover the exaction of usurious interest"); Commonwealth v. Morris, 56 N.E. 896 (Mass. 1980) (affirming a criminal usury conviction in connection with wage assignments); Tolman v. Union Cas. & Sur. Co., 90 Mo. App. 274, 278 (Mo. Ct. App. 1901) (holding that a wage assignment was void as "nothing more than a shift or ruse to evade the statutes against usury"); McWhite v. State, 225 S.W. 542 (Tenn. 1921) (affirming a jury verdict of guilt for criminal usury where wage assignments were taken from railroad employees in connection with advances of money).

100. State *ex rel.* Smith v. McMahon, 280 P. 906, 906 (Kan. 1929).

101. *Id.* at 907 (emphasis and citation omitted).

102. *See* Jeffrey D. Dunn, *Texas Usury Law at the Millennium: A Review of the Historical Development of Texas Usury Law as Applied to the Essential Elements of a Usury Claim*, 19 CORP. COUNS. REV. 227, 240–41 (2000) (discussing the history of Texas's law governing small loans).

103. *Id.*

By the 1960s, the Uniform Consumer Credit Code (UCCC),[104] which also governed credit sales and other consumer transactions, incorporated the most significant aspects of the Uniform Small Loan Law. Revised in 1974, the UCCC has served as a model for the regulation of consumer loans in most states and is the same structure that some legislatures have adopted for the regulation of payday lenders.[105]

B. *State Regulation of Payday Loans*

Because payday lenders originally offered other forms of alternative financial services and otherwise were subject to the same regulation as check cashers, small lenders, and pawn shops, the payday loan developed as a "new product" that seemed to fly under the radar of state regulators.[106] Many believe it resulted in part from a regulatory climate that was largely hands-off, the phenomenal growth of the credit card industry, and the ever-increasing demand for credit.[107] Initial efforts to regulate payday lending were often played out in court through class actions and litigation initiated by state credit commissioners or attorneys general against individual lenders under state usury, unfair and deceptive practice, and debt collection laws.[108] As these lawsuits made their way through the courts, both industry representatives seeking legitimacy and consumer advocates seeking protection petitioned legislatures for regulation.

---

104. UNIF. CONSUMER CREDIT CODE art. 3 (1969).

105. *See* UNIF. CONSUMER CREDIT CODE art. 2 (1974). In Texas, for example, the Administrative Code was amended in 2000 to make clear that the payday loan transaction was a "loan" subject to the state's small loan laws. 7 TEX. ADMIN. CODE ANN. § 83.604(b) (Vernon 2007) (formerly codified at 7 TEX. ADMIN. CODE § 1.605(b) (2000)). *See infra* notes 106–125 and accompanying text.

106. *See* Hamilton v. York, 987 F. Supp. 953, 956 (E.D. Ky. 1997) (denying a defendant check casher's motion to dismiss usury claims on the grounds that a "fee" for a delay in check cashing amounted to interest); Watson v. State, 509 S.E.2d 87 (Ga. Ct. App. 1998) (criminally prosecuting owners of a pawnshop and check cashing business for conspiring to violate a small loan law).

107. *See* PETERSON, *supra* note 16, at 107–09 (describing how deregulation of interest rates contributed to the growth of the credit card industry during the 1980s and to payday lending in the 1990s); Drysdale & Keest, *supra* note 49, at 591 (attributing the growth of alternative financial services, at least in part, to consumer credit's role as a "driving force" in the U.S. economy).

108. *E.g.*, Advance Am. v. Florida, 801 So. 2d 310, 310–11 (Fla. Dist. Ct. App. 2001) (attorney general seeking enforcement of civil investigative subpoenas in connection with claims pursuant to Florida's usury statute); Pinkett v. Moolah Loan Co., No. 99-C-2700, 1999 WL 1080596 (N.D. Ill. Nov. 2, 1999) (certifying a class action asserting violations of federal disclosure law and state usury and consumer protection statutes against a payday lender and denying defendant's motion to dismiss); Commonwealth v. Bar D Fin. Servs., Inc., 1994 WL 1031102, at *2 (Vir. Cir. Ct. Mar. 21, 1994) (entering judgment that all loans made by defendant in violation of state usury loans were "null and void"); *see* Cornyn Press Release, *supra* note 7.

Thirty-six states and the District of Columbia have enacted specific laws or regulations authorizing payday loan transactions with some limitations.[109] At a minimum, such regulation includes licensing of lenders, required disclosures, and limits on the amount of the loan.[110] Rather than prohibiting the triple-digit interest rates payday lenders charged, many states simply capped and codified them.[111] For example, Texas law enables a payday lender to charge $10.93 for a seven-day loan of $100.00, which amounts to a 569.92% APR.[112]

Of the states authorizing some form of payday lending, a few have enacted more stringent controls. For example, Indiana prohibits a payday customer from borrowing more than 20% of her monthly net income,[113] while Florida and Illinois prohibit all rollovers.[114] Florida also maintains an electronic database of such loans,[115] requires credit

---

109. ALA. CODE § 5-18-1 (2007) (Alabama); ALASKA STAT. § 6.50.010 (2007) (Alaska); ARIZ. REV. STAT. ANN. § 6-125 (2008) (Arizona); CAL. FIN. CODE §§ 23000 to 23106 (West 2008) (California); COLO. REV. STAT. ANN. § 5-3.1-101 (West 2008) (Colorado); DEL. CODE ANN. tit. 5, § 2227 (2007) (Delaware); D.C. CODE § 26-301 (2008) (District of Columbia); FLA. STAT. ANN. § 560.401 (West 2007) (Florida); HAW. REV. STAT. § 480F-1 (2007) (Hawaii); IDAHO CODE ANN. § 28-46-401 (2007) (Idaho); 815 ILL. COMP. STAT. ANN. 122/1-1 (West 2007) (Illinois); IND. CODE ANN. § 24-4.5-7-101 (West 2007) (Indiana); IOWA CODE ANN. § 533D.9 (West 2008) (Iowa); KAN. STAT. ANN. § 16a-2-404 (2006) (Kansas); KY. REV. STAT. ANN. § 286.9-010 (West 2007) (Kentucky); LA. REV. STAT. ANN § 9:3578.1 (West 2007) (Louisiana); MICH. COMP. LAWS ANN. § 487.2121 (West 2008) (Michigan); MINN. STAT. ANN. § 47.60 (West 2007) (Minnesota); MISS. CODE ANN. § 75-67-501 (West 2007) (Mississippi); MO. ANN. STAT. § 408.500 (West 2007) (Missouri); MONT. CODE ANN. § 31-7-701 (2007) (Montana); NEB. REV. STAT. § 45-904 (2007) (Nebraska); NEV. REV. STAT. ANN. § 604A.050 (West 2007) (Nevada); N.H. REV. STAT. ANN. § 399-A:13 (2008) (New Hampshire); N.D. CENT. CODE § 13-08-01 (2007) (North Dakota); OHIO REV. CODE ANN. § 1315.35 (West 2008) (Ohio); OKLA. STAT. ANN. tit. 59, § 3101 (West 2007) (Oklahoma); OR. REV. STAT. ANN. § 725.600 (West 2007) (Oregon); R.I. GEN. LAWS § 19-14.4-1 (2007) (Rhode Island); S.C. CODE ANN. § 34-39-110 (2007) (South Carolina); S.D. CODIFIED LAWS § 54-4-36 (2007) (South Dakota); TENN. CODE ANN. § 45-17-101 (West 2007) and TENN. COMP. R. & REGS. 0180-28-.01 (2007) (Tennessee); 7 TEX. ADMIN. CODE § 83.604(b) and TEX. FIN. CODE ANN. §§ 342.251, 342.601 (Vernon 2007) (Texas); UTAH CODE ANN. § 7-23-01 (West 2007) (Utah); VA. CODE ANN. § 6.1-444 (West 2008) and 10 VA. ADMIN. CODE § 5-200-10 (2007) (Virginia); WASH. REV. CODE ANN. § 31.45.010 (West 2008) and WASH. ADMIN. CODE § 208-630-120 (2007) (Washington); WYO. STAT. ANN. § 40-14-362 (2007) (Wyoming). *See also* NAT'L CONSUMER LAW CTR., 2005 SUMMARY OF STATE PAYDAY LOAN ACTS (Nov. 2005), http://web.archive.org/web/200701060859/http://www.consumerlaw.org/action_agenda/payday_loans/content/NCLC_summary.pdf (summarizing the basic features of state laws, including descriptions of applicability, licensing requirements, disclosures, and loan terms); FOX & MIERZWINSKI, *supra* note 8, at 26; Conkey, *supra* note 54 (reporting that thirty-seven states have some form of payday lending regulation).

110. *See* NAT'L CONSUMER LAW CTR., *supra* note 109.

111. FOX & MIERZWINSKI, *supra* note 8, at 8–10.

112. 7 TEX. ADMIN. CODE § 83.604(c).

113. IND. CODE. ANN. § 24-4.5-7-402(1)(b).

114. FLA. STAT. ANN. § 560.404(18); 815 ILL. COMP. STAT. ANN. 122/2-30.

115. FLA. STAT. ANN. § 560.404(19)(a)–(b).

counseling,[116] and imposes a sixty-day grace period with no additional charges to repay the loan.[117] Several other states, including Colorado, Hawaii, Louisiana, New Hampshire, and Oklahoma, prevent payday lenders from pursuing or threatening to pursue criminal charges against borrowers for dishonored checks.[118] In addition, local jurisdictions may impose regulations on payday lenders by prohibiting them from opening for business more than a maximum number of hours each day[119] or operating within a certain distance of a residence or certain other businesses.[120]

Fourteen states effectively prohibit payday loans.[121] Among them is North Carolina, which, ironically, was among the first to enact legislation specifically authorizing them. In 2001, the legislature allowed the statute to lapse under its sunset review process.[122] However, payday loans did not disappear from the state, and, by early 2006, the state attorney general reached an agreement with the lenders that appears, at least for the time being, to stop the practice in that state.[123] In 2005, Georgia enacted legislation criminalizing payday lending,[124] and, in 2006, New Mexico enacted regulations that permit payday lenders to charge no more than a one-time flat fee to make an otherwise interest-free loan.[125]

---

116. § 560.404(20).

117. § 560.404(22)(a).

118. COL. REV. STAT. ANN. § 5-3.1-112 (2007); HAW. REV. STAT. § 480F-6 (2007); LA. REV. STAT. ANN. § 9:3578.6(5) (2007); N.H. REV. STAT. ANN. § 399-A:13(X) (2007); OKLA. STAT. ANN. tit. 59, § 3107(B) (West 2007).

119. *E.g.*, PITTSBURGH, PA. CODE § 911.04.A.93 (2007) (setting a maximum number of hours of operation for payday lenders).

120. *E.g.*, TEMPE, ARIZ. ZONING & DEV. CODE §§ 3-423(A), 7-107 (2007) (requiring payday lenders and other "non-chartered financial institutions," to be at least 1,320 feet from another such institution and at least 500 feet from any residential lot); PITTSBURGH, PA. CODE § 911.04.A.93 (requiring at least 1,000 feet between payday lenders and between lenders and certain other businesses, including arcades and pool halls, as well as 500 feet from any residence). *See also* Ian McCann, *Zoning for Payday Lenders Considered*, DALLAS MORNING NEWS, Nov. 19, 2007, at 1B; Chattanooga-Hamilton County Reg'l Planning Agency, *Alternative Financial Services: Chattanooga, Tennessee*, July 2006.

121. The states effectively prohibiting payday lending are Arkansas, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, New Mexico, North Carolina, Pennsylvania, Vermont, West Virginia, and Wisconsin.

122. N.C. GEN. STAT. ANN. § 53-281 (expired eff. Aug. 31, 2001).

123. CTR. FOR RESPONSIBLE LENDING, DEMISE OF PAYDAY LENDING IN NORTH CAROLINA, http://www.responsiblelending.org/policy/state/north-carolina/NCpayday2006.html (last visited Feb. 15, 2008); Press Release, NC Dep't of Justice, Roy Cooper, North Carolina Attorney Gen., Payday Lending on the Way Out in NC (Mar. 1, 2006), *available at* http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=paydaylenders3.06.pdf.

124. GA. CODE ANN. § 16-17-2 (West 2007).

125. *See* Press Release, Office of the Governor of the State of New Mexico, Bill Richardson, Governor Richardson, Attorney General Madrid File Tough New Payday Lending Regulations

C. *Other State Regulation*

In addition to laws specifically directed at payday lending, other state laws may also be applicable to payday loans. As noted above,[126] early efforts to curb the practice used state laws prohibiting unfair and deceptive acts and practices, which may apply through prohibitions against misrepresenting the character of a contract and receiving or delivering post-dated checks.[127] While state laws criminalizing the passing of bad checks and, in some cases, providing for civil penalties can be used by lenders attempting to collect payday loans, state and federal laws preventing abusive collection practices may also act as a form of payday lender regulation.[128]

D. *The Federal Landscape*

In October 2006, Congress took the bold step of capping payday loan rates for military personnel and their families.[129] Its action was a quick response to the DoD Report issued in August 2006 recommending that a federal cap be imposed upon the cost of credit to military personnel and their families.[130] While its effort was generally lauded among consumer advocates,[131] it provided no relief to the high interest rates paid by millions of non-military families. Still, payday loans are governed by a number of federal statutes applicable to all consumer credit transactions.[132] For example, the Truth-in-Lending Act (TILA) applies on its face to payday lenders who qualify as creditors under TILA, because they regularly extend consumer credit and

---

(July 31, 2006), *available at* http://www.nmag.gov/Articles/archive/2006/pdf/07-31-06_payday_regs.pdf.

126. *See supra* note 108 and accompanying text.

127. *See* TEX. BUS. & COM. CODE ANN. § 17.46(b)(12) (Vernon 2007) (defining a deceptive trade practice as "representing that an agreement confers or involves rights, remedies, or obligations which it does not have or involve, or which are prohibited by law").

128. *E.g.*, TEX. FIN. CODE ANN. §§ 392.001–392.404 (Vernon 2007).

129. John Warner National Defense Authorization Act for Fiscal Year 2007, H.R. 5122, 109th Cong. (2006) (codified at 10 U.S.C. § 987 (Supp. 2007)).

130. DOD REPORT, *supra* note 17. The DoD Report made a number of other recommendations to protect military families from non-mortgage based predatory lending practices. Those recommendations are discussed more fully below. *See infra* Part IV and accompanying text.

131. *See, e.g.*, Statement of Michael Calhoun, President, Ctr. for Responsible Lending, Calhoun Commends Members of Congress for Protecting Our Military from Predatory Lenders (Sept. 29, 2006), http://www.responsiblelending.org/press/releases/page.jsp?itemID=30529730; Press Release, Nat'l Consumer Law Ctr., NCLC Applauds Military Predatory Lending Measure (Sept. 29, 2006), http://www.consumerlaw.org/issues/military/content/PressTalent-Nelson.pdf.

132. Truth-in-Lending Act, 15 U.S.C. §§ 1601–1667f (2000 & Supp. 2005); Equal Credit Opportunity Act, 15 U.S.C. §§ 1691–1691f (2000 & Supp. 2005); Fair Credit Reporting Act, 15 U.S.C. §§ 1681–1681u (2000 & Supp. 2005); Fair Debt Collection Practices Act, 15 U.S.C. §§ 1692–1692*o* (2000 & Supp. 2005); Federal Trade Commission Act, 15 U.S.C. §§ 41–58 (2000 & Supp. 2007).

require a finance charge.[133] Borrowers incur consumer debt under TILA by obtaining the right to defer payment of debt or to incur debt and defer its payment for personal, family, or household expenses.[134]

TILA requires lenders to disclose the cost of credit both as a dollar amount and an APR. Because payday loans do not fall within TILA's definition of an open extension of credit, payday lenders must comply with section 128, which requires disclosure at the time of the loan of not only the amount financed and the finance charge—for example, $10 on $100—but also the finance charge expressed as an APR.[135] In the early days of payday lending, some lenders claimed that they were not subject to TILA's requirements, because they were not extending credit within the meaning of TILA.[136] Today, however, the industry admits that its transactions are subject to TILA and lists, as first among its Best Practices, the requirement of compliance with state and TILA disclosures.[137]

The Equal Credit Opportunity Act (ECOA)[138] prevents payday lenders from taking into account "race, color, religion, national origin, sex or marital status, [] age," or the fact that an applicant's income derives from any public assistance program.[139] In 2005, the Federal Deposit Insurance Corporation (FDIC) warned member and non-member banks engaging in payday lending to ensure that their evaluation practices, rates, fees, and marketing strategies did not run afoul of the ECOA.[140]

In addition to this patchwork system of state and federal regulation, federal banking regulators also began to consider the effect of payday lending when federally insured banks increasingly partnered with payday lenders to export more favorable interest rates to borrowers in other states. Thus, even in states that purport to ban payday loans, consumers may have access to them over the internet[141] or through

---

133. 15 U.S.C. § 1602(f).

134. § 1602(e) (defining credit as "the right granted by a creditor to a debtor to defer payment of a debt or to incur debt and defer its payment"); Regulation Z, 12 C.F.R. § 226.2(14) (2007). *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 37–40 (2002) (discussing an Ohio survey showing that lenders failed to provide basic information to debtors before making the loan).

135. 15 U.S.C. § 1638(a)(4).

136. *E.g.*, Hamilton v. York, 987 F. Supp. 953, 956 (E.D. Ky. 1997) (rejecting a lender's argument that fees were service charges for cashing checks and, therefore, not governed by TILA).

137. *See* CFSA, *supra* note 58.

138. 15 U.S.C. §§ 1691–1691f (Supp. 2007).

139. § 1691(a)–(b).

140. FDIC, Guidelines for Payday Lending, http://www.fdic.gov/regulations/safety/payday (last visited Feb. 15, 2008).

141. *See* FOX & MIERZWINSKI, *supra* note 8.

business arrangements with national and state banks, as discussed in the next subsection.

1. *Another of Hydra's Many Heads*

Payday lenders' ability to make loans in states where they are prohibited flows from the 1978 case *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, where the U.S. Supreme Court interpreted section 85 of the National Banking Act to permit a national bank, credit union, or savings association to charge borrowers interest at the rate allowed by the law of the state where the bank was located—even to its out-of-state customers.[142] When state banks complained of unfair competition, Congress responded by extending the same protections to state-chartered banks under the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA).[143] Both federal laws preempt any state law that inhibits banks' ability to charge the highest interest rate allowed by law in their home states.

Payday lenders used federal preemption under the National Banking Act and DIDMCA to partner with banks in other states, allowing them to charge the interest rate permitted by the bank's home state regardless of the highest rate permitted in the payday lender's home state.[144] Instead of the bank itself offering the credit, the payday lender associates with the national or state-chartered bank to act as its agent, not only to originate the loan, but also to collect it.[145] Consumer advocates critical of the practice charged that the banks were simply renting out their charters to the non-bank payday lenders to avoid state regulation.[146] Industry representatives responded that they were acting within the letter of the law that permits them to export higher out-of-state interest rates to in-state customers.[147]

2. *The Challenges*

By 2000, state regulators in Colorado, Ohio, and Maryland brought enforcement actions against payday lenders who partnered with out-of-state banks. In 2001, the Colorado attorney general brought suit against ACE, the largest check casher in the country, after ACE sur-

142. 439 U.S. 299, 308, 313–14 (1978) (citing 12 U.S.C. § 85).

143. 12 U.S.C. § 1831d(a) (Supp. 2007). DIDMCA also effectively preempts state usury laws for most purchase money mortgages. § 1735f-7 (Supp. 2007).

144. *See* FOX & MIERZWINSKI, *supra* note 8, at 14; PETERSON, *supra* note 16, at 107–09; Drysdale & Keest, *supra* note 49, at 605.

145. FOX & MIERZWINSKI, *supra* note 8, at 15–16.

146. *See id.*

147. *See id.*

rendered its lending license in the state but not its lending activities on the theory that its arrangement with Goleta National Bank of California obviated the need to comply with state law. The suit resulted in a settlement, which provided for more than a million dollars in restitution for Colorado consumers and required ACE to immediately comply with state law and sever its arrangement with Goleta.[148]

Consumer class actions in Texas, Oklahoma, and New Jersey asserted a wide variety of claims, including some under federal racketeering laws, and charged that payday lenders associated with national banks in a conspiracy to violate state law.[149] The results of the suits have varied. For example, New Jersey courts have failed to reach the merits of *Muhammad v. County Bank of Rehoboth Beach, Delaware*,[150] even though more than three years have elapsed since the suit was filed, because courts have considered only the enforceability of a mandatory arbitration clause contained in the loan contract. In April 2007, the U.S. Supreme Court denied the lenders' petition for certiorari, resulting in the case's return to the state courts for determination of the enforceability of the clause.[151] On the other hand, in 2003, parties in the Texas case of *Purdie v. Ace Cash Express, Inc.* reached a court-approved agreement requiring the lender to repay a minimum of $2.5 million to class members and forgive another $52 million in debt, among other things.[152]

Meanwhile, both the Office of the Comptroller of the Currency (OCC), which supervises national banks, and the FDIC, which insures them, issued general warnings to banks about payday-lending activities. They warned that bank arrangements with payday lenders had the potential to threaten the fiscal soundness of a lending institution and violate its charter provisions.[153] Noting that "minimum capital requirements" established for many banks are generally based on conservative risk taking, the FDIC warned banks that such minimums "are not sufficient to offset the risks associated with payday lending"

---

148. Ben Jackson, *Ace Settlement: Another Blow to Payday Lenders*, AM. BANKER, May 13, 2002, *available at* http://www.americanbanker.com/printthis.html?id=2002051040XOW20D.

149. *E.g.*, Flowers v. EZPawn Okla., Inc., 307 F. Supp. 2d 1191 (N.D. Okla. 2004); Purdie v. Ace Cash Express, Inc., No. Civ.-A.-301-CV-1754L, 2003 WL 22976611, at *1 (N.D. Tex. Dec. 11, 2003); Muhammad v. County Bank of Rehoboth Beach, Del., 912 A.2d 88 (N.J. 2006), *cert. denied*, 127 S. Ct. 2032 (2007).

150. 912 A.2d 88.

151. 127 S. Ct. 2032.

152. 2003 WL 22976611, at *9.

153. *See* FDIC, Guidelines for Payday Lending, *supra* note 140; *see also* OCC Advisory Letter No. AL 2000-10, Comptroller of the Currency, Adm'r of Nat'l Banks, to Chief Executive Officers of All Nat'l Banks, Dep't and Div. Heads, and All Examining Pers. (Nov. 27, 2000), *available at* http://www.occ.treas.gov/ftp/advisory/2000-10.doc.

and that increased levels—"perhaps as high as 100% of the loans outstanding"—may be warranted.[154]

Originally, the OCC took the position that payday lenders were not entitled to the preemption protection of banks.[155] For example, in October 2002, the OCC ordered ACE Cash Express, Inc. to stop making payday loans through a California bank to customers in eighteen states to protect the safety and soundness of the bank.[156] In January 2003, Cash America, Inc., the Fort Worth-based lender, ended its relationship with a South Dakota Bank "just hours before" an OCC intervention was to take effect.[157] That January, the OCC ordered People's National Bank of Paris, Texas, a $102 million community bank, to pay $175,000 in penalties and terminate its arrangements with Advance America, Cash Advance Centers, Inc., a South Carolina payday lender. The OCC maintained that the bank lacked an adequate audit system and failed to exercise sufficient control of the lender's activities.[158]

In January 2003, the FDIC issued its first "Guidelines for Payday Lending," which stated that payday borrowers "generally have cash flow difficulties" and that some payday lenders perform only "minimal analysis of the borrower's ability to repay."[159] The FDIC concluded that a "combination of the borrower's limited financial capacity, the unsecured nature of the credit, and the limited underwriting analysis of the borrower's ability to repay pose[d] [a] substantial credit risk for insured depository institutions" affiliating with payday lenders.[160]

---

154. FDIC, Guidelines for Payday Lending, *supra* note 140.

155. *See* Fox & Mierzwinski, *supra* note 8, at 18–19.

156. David Smith, *Regulators Tell Payday Lender, Cut Ties to Bank*, Arkansas-Democrat Gazette, Oct. 31, 2002, at 33.

157. Press Release, OCC Concludes Case Against First National Bank in Brookings Involving Payday Lending, Unsafe Merchant Processing, and Deceptive Marketing of Credit Cards (Jan. 21, 2003), *available at* http://www.occ.treas.gov/toolkit/newsrelease.aspx?Doc=C4GDHG41.xml.

158. Consent Order at 4, *In re* Peoples Nat'l Bank, Paris, Tex., No. AA-EC-02-03 (Dep't of Treasury Jan. 30, 2003), *available at* http://www.occ.treas.gov/ftp/eas/ea2003-2.pdf.

159. *See* FDIC, Guidelines for Payday Lending, *supra* note 140.

160. *See id.* The FDIC warned banks that a partnership with a third party "in no way diminishes the responsibility of [bank boards] and management to ensure that [lending] is conducted in a safe and sound manner and in compliance with policies and applicable laws." *Id.* To ensure safety and soundness, the FDIC instructed examiners to ensure that management sufficiently monitors the banks' arrangements with payday lenders and reviews arrangements with third parties to ensure that written agreements had been approved by banks' boards. The FDIC also identified certain minimum standards for such contracts:

- Describe the duties and responsibilities of each party, including the scope of the arrangement, performance measures or benchmarks, and responsibilities for providing and receiving information;
- Specify that the third party will comply with all applicable laws and regulations;

In February 2005, the FDIC tightened its guidelines by providing institutions with more guidance in connection with renewals and extensions of such loans, commonly called "rollovers."[161] Specifically, it advised institutions to limit the number and frequency of extensions, to prohibit additional advances to finance unpaid interest, to establish "cooling off" or waiting periods between repayment of one payday loan and application for another, to establish maximum numbers of loans per customer per year, and, perhaps most importantly, to "[e]nsure that payday loans are not provided to customers who had payday loans outstanding at any lender for a total of three months during the previous 12 months."[162]

IV. CSOs and Payday Loans

As increased federal oversight of payday lenders threatened to reduce profits, some lenders returned to reliance on state laws and a little-known regulatory scheme designed to protect consumers from financial hardship caused by unscrupulous businesses making promises they do not keep. Section A provides background regarding the development of the CSO and its regulation.[163] Section B examines one court's analysis of how CSO legislation can impact small loan laws and how payday lenders have extended that analysis to their benefit.[164]

A. *What Is a CSO and How Is It Regulated?*

CSO legislation originally targeted businesses known somewhat pejoratively as "credit repair organizations." Indeed, one FTC official stated that, "[a]lthough there are legitimate, not-for-profit *counseling* services, the FTC has never seen a legitimate credit *repair* com-

---

- Specify which party will provide consumer compliance related disclosures;
- Authorize the institution to monitor the third party and periodically review and verify that the third party and its representatives are complying with its agreement with the institution;
- Authorize the institution and the appropriate banking agency to have access to such records of the third party and conduct onsite transaction testing and operational reviews at third party locations as necessary or appropriate to evaluate such compliance;
- Require the third party to indemnify the institution for potential liability resulting from action of the third party with regard to the payday lending program; and
- Address customer complaints, including any responsibility for third-party forwarding and responding to such complaints.

Id.

161. *See id.*

162. *Id.* (emphasis omitted).

163. *See infra* notes 165–198 and accompanying text.

164. *See infra* notes 199–236 and accompanying text.

pany."[165] Such businesses offered a quick, if sometimes deceptive, fix for consumers desperate for relief from creditors and debt collectors. Entities reportedly charged or collected high fees for services prior to their being performed, counseled or advised consumers to make false statements in connection with obtaining new credit, and even charged fees for the referral of a consumer to a creditor who would have extended credit to the consumer upon substantially the same terms in the absence of the referral.[166] Recently, there have been reports of internet offers to "improve" a consumer's credit by renting the credit scores of unrelated persons with better scores for fees up to $2,000.[167] Such conduct also exists in the nonprofit sector, where the Internal Revenue Service (IRS) warned last year that "tax-exempt credit counseling became a big business dominated by bad actors."[168] Last year, the IRS reported that many entities "offered little or no counseling or education and appeared to be primarily motivated by profit," serving "the private interests of related for-profit businesses, officers and directors."[169]

On the other hand, legitimate counseling services provide overextended consumers with conservative strategies for pulling their heads above water. Such strategies may include timely payment of bills to avoid late charges, calculation of and advice regarding budgets, and tips on avoiding unwanted holiday- or vacation-related debt and on avoiding a short-term financial crisis.[170] In fact, Congress now requires that debtors obtain credit counseling under the Bankruptcy Abuse Prevention Consumer Protection Act of 2005 (BAPCPA) before they can qualify as a debtor under the Bankruptcy Code.[171] Such services must be provided by a "nonprofit budget and credit

---

165. *See* Press Release, Fed. Trade Comm'n, Credit Repair? Buyer Beware! FTC, States Announce Crackdown On Scams That Bilk Consumers (Mar. 5, 1998), *available at* http://www.ftc.gov/opa/1998/03/eraser.shtm (emphasis in original).

166. CAL. CIV. CODE § 1789.13(a) (West 2007) (prohibiting CSOs from charging a fee prior to full performance).

167. Kenneth Harney, *Piggyback Credit Score Schemes Still Running Hog Wild*, S.F. CHRON., Nov. 4, 2007, at K-14.

168. Press Release, IRS Takes New Steps on Credit Counseling Groups Following Widespread Abuse (May 15, 2006), *available at* http://www.irs.gov/newsroom/article/0,,id=156996,00.html (internal quotation marks omitted). In a two-year period ending in May 2006, the IRS conducted forty-one audits of nonprofit credit counseling firms accounting for more than 40% of the industry; all of the audits resulted in "revocation, proposed revocation or other termination of tax-exempt status." *Id.*

169. *Id.*

170. *See* Alliance Credit Counseling, Inc. Home Page, http://www.knowdebt.org (last visited Feb. 15, 2008) (providing numerous tools and suggestions for consumers to manage credit, debt, and budgets).

171. 11 U.S.C. § 109(h)(1) (Supp. 2005).

counseling agency" approved by the U.S. Trustee within 180 days before filing a bankruptcy petition.[172]

A 1984 California statute was the first to combat deceptive conduct in this area. It protects consumers seeking "to obtain credit or improve credit standing" by encouraging the availability of "information necessary to make an intelligent decision regarding the purchase of those services and to protect the public from unfair or deceptive advertising and business practices."[173] In a relatively short time, thirty-seven states and the District of Columbia followed California's lead.[174] In 1996, Congress enacted the Credit Repair Organizations

172. *Id.* The U.S. Trustee maintains a website consumers can use to locate approved credit counselors in their area. U.S. Trustee Program, http://www.usdoj.gov/ust/eo/bapcpa/ccde/index.htm (last visited Feb. 15, 2008). Alliance Credit Counseling, Inc. is one such counselor. *See* http://www.usdoj.gov/ust/eo/bapcpa/ccde/CC_Files/CC_Approved_Agencies_HTML/cc_texas/cc_texas.htm (last visited Feb. 15, 2008). While individual debtors typically file for relief under Chapters 7 or 13 of the Bankruptcy Code, section 109(h) is nonspecific enough to impute this requirement to individuals who file under Chapter 11. *See, e.g.*, *In re* Dixon, 338 B.R. 383, 386 (B.A.P. 8th Cir. 2006).

173. CAL. CIV. CODE § 1789.11(b) (West 2007).

174. ARIZ. REV. STAT. ANN. §§ 44-1701 to 44-1712 (2007) (Arizona); ARK. CODE ANN. §§ 4-9-101 to 4-9-109 (West 2008) (Arkansas); COLO. REV. STAT. ANN. §§ 12-14.5-101 to 12-14.5-113 (West 2007) (Colorado); CONN. GEN. STAT. ANN. § 36a-700 (West 2007) (Connecticut); DEL. CODE ANN. tit. 6, §§ 2401 to 2414 (2007) (Delaware); D.C. CODE §§ 28-4601 to 28-4608 (2008) (District of Columbia); FLA. STAT. ANN. §§ 817.7001, 817.7005 (West 2008) (Florida); GA. CODE ANN. § 16-9-59 (West 2007) (Georgia); 815 ILL. COMP. STAT. ANN. 605/1 to 605/4 (West 2007) (Illinois); IND. CODE ANN. §§ 24-5-15-1 to 24-5-15-11 (West 2007) (Indiana); IOWA CODE ANN. §§ 538A.1 to 538A.14 (West 2008) (Iowa); KAN. STAT. ANN. §§ 50-1116 to 50-1135 (2006) (Kansas); LA. REV. STAT. ANN. §§ 9:3573.1 to 9:3573.17 (2007) (Louisiana); ME. REV. STAT. ANN. tit. 9-A, §§ 10-101 to 10-401 (2007) (Maine); MD. CODE ANN. COM. LAW §§ 14-1901 to 14-1916 (West 2008) (Maryland); MASS. GEN. LAWS ANN. ch. 93, §§ 68A to 68E (2008) (Massachusetts); MICH. COMP. LAWS ANN. §§ 445.1821 to 445.1826 (West 2008) (Michigan); MINN. STAT. ANN. §§ 332.52 to 332.60 (West 2007) (Minnesota); MO. ANN. STAT. §§ 407.635 to 407.644 (West 2007) (Missouri); MONT. CODE ANN. §§ 30-14-2001 to 30-14-2015 (2007) (Montana); NEB. REV. STAT. §§ 45-801 to 45-815 (2007); NEV. REV. STAT. ANN. §§ 598.741 to 598.787 (West 2007); N.H. REV. STAT. ANN. §§ 359-D:1 to 359-D:11 (West 2008) (New Hampshire); N.Y. GEN. BUS. LAW §§ 458-a to 458-k (McKinney 2008) (New York); N.C. GEN. STAT. ANN. §§ 66-220 to 66-226 (West 2007) (North Carolina); OHIO REV. CODE ANN. §§ 4712.01 to 4712.99 (West 2008) (Ohio); OKLA. STAT. ANN. tit. 24, §§ 131–148 (West 2007) (Oklahoma); OR. REV. STAT. ANN. §§ 646.380 to 646.398 (West 2007) (Oregon); 73 PA. CONS. STAT. ANN. §§ 2181 to 2192 (West 2007) (Pennsylvania); S.C. CODE ANN. §§ 37-7-101 to 37-7-122 (2007) (South Carolina); TENN. CODE ANN. §§ 47-18-1001 to 47-18-1011 (West 2007) (Tennessee); TEX. FIN. CODE ANN. §§ 393.001 to 393.505 (Vernon 2007) (Texas); UTAH CODE ANN. §§ 13-21-1 to 13-21-9 (West 2007) (Utah); VA. CODE ANN. §§ 59.1-335.1 to 59.1-335.12 (West 2008) (Virginia); WASH. REV. CODE ANN. §§ 19.134.010 to 19.134.900 (West 2008) (Washington); W. VA. CODE ANN. §§ 46A-6C-1 to 46A-6C-12 (West 2007) (West Virginia); WIS. STAT. ANN. §§ 422.501 to 422.506 (West 2007) (Wisconsin).

Act after more than three years of deliberations on the subject,[175] expressly recognizing the widespread state legislation.[176]

In a 1994 letter to a state legislative committee, the Office of the Attorney General of Texas (the "Attorney General" or the "Office") described the situation that the Texas statute was designed to remedy:

> The Federal Fair Credit Reporting Act, passed in 1970, entitles consumers who are denied credit based on a credit report the right to review and correct the contents of their credit file at no charge. Reportedly, consumers have paid extensive fees to companies to investigate their credit records. There is a concern that the consumer is misled by some operators who promise to solve consumer credit woes and clean up a bad credit history.[177]

Unlike state legislation targeting deceptive trade practices, which varies widely from state to state,[178] statutes regulating CSOs define the entity in remarkably similar terms.[179] For example, California defined a CSO as follows:

---

175. *See* Credit Repair Organizations Act (CROA), 15 U.S.C. §§ 1679–1679j (2000 & Supp. 2005). In 1994, the U.S. House of Representatives issued a report in connection with a precursor of the 1997 CROA, noting that entities often misled consumers into believing "that adverse information in their consumer reports [could] be deleted or modified regardless of its accuracy" when, in general, adverse information could be deleted only after seven years, "or in the case of bankruptcy, 10 years." H.R. Rep. No. 103-486, 103rd Cong. (1994) (cited in Eugene J. Kelley, Jr. et al., *The Credit Repair Organization Act: The "Next Big Thing?,"* 57 CONSUMER FIN. L.Q. REP. 49, 50 & n.5 (2003) (noting that the 1994 bill was not enacted but became the basis for the CROA and that the House and Senate Reports for the 1994 bill constitute the legislative history of the 1997 CROA)). Few cases have interpreted the CROA, but one has found that it applies to a law firm advertising its ability to remove negative credit information, even if accurate, from a consumer's credit reports; another court applied the CROA to web-based services offering to provide personalized credit information services when, in fact, it provided only generalized, computer-generated information. *See* Fed. Trade Comm'n v. Gill, 265 F.3d 944, 955–56 (9th Cir. 2001) (law firm); Slack v. Fair Isaac Corp., 390 F. Supp. 2d 906, 910–14 (N.D. Cal. 2005) (web-based service).

176. Kelley, Jr. et al., *supra* note 175, at 55.

177. Letter from Kymberly K. Oltrogge, Assistant Att'y Gen., to Hon. Mark W. Stiles, Chair of Calendars Comm. (Mar. 24, 1994), *available at* http://www.oag.state.tx.us/opinions/lo48morales/lo94-029.txt [hereinafter Oltrogge Letter].

178. *Compare* MASS. GEN. LAWS ANN. ch. 93A, § 2(a) (West 2008) (defining deceptive trade practices in general terms), *with* OR. REV. STAT. ANN. § 646.608(1)(a)–(eee) (West 2005) (defining deceptive trade practices as falling within a detailed list of specifically prohibited conduct).

179. *See, e.g.*, DEL. CODE ANN. tit. 6, § 2401 (2007); 205 ILL. COMP. STAT. ANN. 605/3(d) (West 2007); MD. CODE ANN. COM. LAW § 14-1901(e) (West 2008); TEX. FIN. CODE ANN. § 393.001(3) (Vernon 2007); *but cf.* N.Y. GEN. BUS. LAW § 458-b (McKinney 2008). New York defines a CSO more narrowly:

> Any person who sells, provides, or performs, or represents that he can or will sell, provide or perform, a service for the express or implied purpose of improving a consumer's credit record, history, or rating or providing advice or assistance to a consumer with regard to the consumer's credit record history or rating in return for the payment of a fee.

Id.

> [A] person who, with respect to the extension of credit by others, sells, provides, or performs, or represents that he or she can or will sell, provide or perform, any of the following services, in return for the payment of money or other valuable consideration:
> (1) Improving a buyer's credit record, history, or rating.
> (2) Obtaining a loan or other extension of credit for a buyer.
> (3) Providing advice or assistance to a buyer with regard to either paragraph (1) or (2).[180]

On its face, the definition is extremely broad, and California's statute, like Texas's and other states' statutes,[181] exempts several categories of businesses, including licensed lenders,[182] federally insured banks,[183] most attorneys,[184] and most tax-exempt nonprofit organizations.[185] Nevertheless, the breadth of the definition is apparent on first reading and, in some states, unless specifically exempted, entities such as mortgage brokers are included within its terms.[186] Increasingly, the line is difficult to draw. For example, an Ohio court found that a company that advertised "personal loans up to $50,000" for consumers with credit problems must comply with the Act,[187] but an Illinois court using the same definition held that a car dealership and a home re-

180. CAL. CIV. CODE ANN. § 1789.12(a)(1)–(3) (2008).

181. *See supra* note 174.

182. CAL. CIV. CODE ANN. § 1789.12(b)(1).

183. § 1789.12(b)(2).

184. § 1789.12(b)(5). Significantly, however, at least one court has held that the CROA applied to a law office. Fed. Trade Comm'n v. Gill, 265 F.3d 944, 955–56 (9th Cir. 2001).

185. CAL. CIV. CODE ANN. § 1789.12(b)(7). The exemption for nonprofit organizations is as follows:

> (7) Any nonprofit organization described in Section 501(c)(3) of the Internal Revenue Code that, according to a final ruling or determination by the Internal Revenue Service, is both of the following:
> (A) Exempt from taxation under Section 501(a) of the Internal Revenue Code.
> (B) Not a private foundation as defined in Section 509 of the Internal Revenue Code.
>
> An advance ruling or determination of tax-exempt or foundation status by the Internal Revenue Service does not meet the requirements of this paragraph.

Id.; *see also* ARIZ. REV. STAT. ANN. § 44-1702(6) (West 2007); GA. CODE ANN. § 16-9-59(a)(2)(B)(iii) (West 2007); MO. ANN. STAT. § 407.635.2(4) (West 2007); TEX. FIN. CODE ANN. §§ 393.002(a)(5) (Vernon 2007). The CROA also excludes tax-exempt nonprofit organizations. 15 U.S.C. § 1679a(3)(B)(i) (2000 & Supp. 2005). Exemption from regulation under the CROA does not mean, however, that the tax-exempt nonprofit organization is free from regulation. Since 2004, the IRS has undertaken steps to ensure that these organizations comply with the Internal Revenue Code. *See supra* notes 168–169.

186. *See* Oltrogge Letter, *supra* note 177.

187. Ohio *ex rel.* Petro v. Berks Fin., No. 03-CV-8373, 2004 WL 3736495 (Ohio Court of Common Pleas Aug. 4, 2004).

modeling company, both of which arranged loans with third-party lenders, fell outside of the Act's scope.[188]

In general, state statutes governing CSOs require that they register with the state and file a bond.[189] Like the federal statute, state statutes also require complete disclosure of available services and consumer rights under federal law, written contracts, and, in some cases,[190] a limited right of rescission.[191] In addition, they may provide criminal penalties, as well as civil remedies, for consumers injured by violations of the act.[192] While the statutes uniformly prevent fee prepayments,[193] they do not limit the amount of fees that may be charged.[194] This last feature provides the means by which payday lenders have reemerged after federal guidelines severely curtailed their activities.[195]

In a 2006 letter to the state's consumer credit commissioner, the Attorney General responded to inquiries regarding payday lenders' use of the CSO model to "arrange for credit" with a third party for a fee.[196] Acknowledging that the fees were often higher than under the previous payday loan model, the response is a marked change from the Office's approach less than seven years earlier when it embarked on a highly visible campaign to curtail payday lenders' activities.[197] The 2006 letter adopts a "plain language" approach to the statute, concluding that, because the statute fails to limit fees charged by the CSO for placement of a loan with a third-party lender, the payday lender licensed as a CSO who arranges for credit with a third party

188. Cannon v. William Chevrolet/Geo, Inc., 794 N.E.2d 843 (Ill. App. Ct. 2003) (car dealership is not within the scope of the act); Midstate Siding & Window Co. v. Rogers, 789 N.E.2d 1248 (Ill. 2003) (remodeling company is not within the scope of the act).

189. *E.g.*, TEX. FIN. CODE ANN. § 393.301(a) (Vernon 2007) (registration); § 393.401 (surety bond).

190. § 393.201 (forms and terms of contract).

191. FLA. STAT. ANN. § 817.704(1)(a) (West 2005) (five-day right of rescission); TEX. FIN. CODE ANN. § 393.202(a) (Vernon 2006) (three-day right of rescission).

192. FLA. STAT. ANN. § 817.705(3), 817.706 (making violations a third-degree felony and permitting actions for damages); TEX. FIN. CODE ANN. § 393.202(a); *cf.* GA. CODE ANN. § 16-9-59(c) (West 2007) (misdemeanor).

193. TEX. FIN. CODE ANN. § 393.501.

194. *Cf.* 11 U.S.C. § 111(c)(2)(B) (Supp. 2005) (Bankruptcy Code provision requiring approved nonprofit credit counseling services to charge only a "reasonable fee" and "to provide services without regard to the [consumer's] ability to pay the fee").

195. *See supra* notes 142–147 and accompanying text.

196. Letter from Barry R. McBee, First Assistant Att'y Gen. to Leslie Pettijohn, Comm'r, Office of the Consumer Credit Commissioner (Jan. 12, 2006) (on file with author) [hereinafter McBee Letter].

197. *Compare* Cornyn Press Release, *supra* note 7, *with* McBee Letter, *supra* note 196.

may charge fees even higher than those charged by traditional payday lenders.[198]

B. Lovick v. Ritemoney Ltd.

The Attorney General's informed opinion was based in part on the Fifth Circuit's decision in *Lovick v. Ritemoney Ltd.*[199] In *Lovick*, the court held that the $1,500 fee charged by a loan broker under the state's CSO statute to secure a loan from a third party at 10% interest did not amount to an evasion of the usury laws.[200] The court's analysis and its impact on payday lenders is examined more fully below.

1. The Facts

In January 2002, Betty Lovick saw an advertisement in the *Greensheet*, a Houston weekly newspaper advertising "CAR TITLE LOANS UP TO $5000."[201] A "title loan" or "auto-pawn loan" is a personal loan unconnected to the purchase of a car, which is secured by a lien on the borrower's car.[202] Ads had been running in the *Greensheet* since 2001 and originally advertised that the loans were available from Power Financial, an assumed name for CPCWA Company, Ltd. Responding to the ad, Betty Lovick obtained a $2,000 loan, which she learned was to originate from Ritemoney, with CPCWA serving as the loan broker.[203] She signed a promissory note to Ritemoney, a loan disclosure statement, and a security agreement. Although the total amount financed was $2,013, which included $13 for the cost of filing a lien on her car,[204] the total amount to be repaid in twelve monthly installments totaled $3,706.20, which included a $1,500 "third-party fee" described in the loan documents as follows:

> Payment of third-party fees: In connection with any third-party fees such as fees for loan brokerage or other credit services, I acknowledge the following: I separately contracted with another company or person to receive brokerage or other credit services and agreed to pay for those services; I am responsible for such fees; I am voluntarily using part of this loan to pay for those fees; and I understand that this loan is made by lender [Ritemoney] under Section 302.001

198. *See* McBee Letter, *supra* note 196.
199. 378 F.3d 433 (5th Cir. 2004).
200. *Id.* at 436.
201. Brief for Appellant at 4, Lovick v. Ritemoney, Ltd., No. 03-20917 (5th Cir. Nov. 10, 2003), *available at* 2003 WL 24162721.
202. *See* PETERSON, *supra* note 16, at 25–28 (explaining that many car title lenders hold a copy of the title and a copy of the keys to the vehicle as security for the loan, the interest for which can be as high as 900%).
203. Brief for Appellant, *supra* note 201, at 7.
204. *Id.*

of the Texas Finance Code at a rate of interest not greater than 10% per annum and that a fee paid to a third-person [CPCWA] for arranging this loan (though required to be treated as finance charge for purposes of federal law disclosures) is for a separate service and not interest for purposes of Texas law.[205]

In January 2003, after Lovick had fully repaid the loan, she filed suit against Ritemoney, Ltd. as a lender and CPCWA as a broker,[206] alleging a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO),[207] with the collection of an unlawful debt as the predicate act.[208]

Specifically, Lovick claimed that the $1,500 third-party fee was not a bona fide charge, but rather amounted to "disguised interest" charged by the lender as a "joint participant" with CPCWA in an effort to evade the state's usury laws, which permitted only 10% interest on the $2,000 loan.[209] In support of her claims, Lovick alleged the following: (1) CPCWA and Ritemoney maintained an exclusive relationship in which CPCWA brokered all of its title loans through Ritemoney and Ritemoney extended title loans only through CPCWA; (2) CPCWA performed all of the tasks traditionally performed by a lender—for example, "arranging advertising, credit review, collateral inspection, approval decision, paperwork preparation, issuance and cashing of checks, [and] collection of payment"—and decided when to exercise creditor's rights to repossess the automobiles; and (3) payment of the brokerage fee was a prerequisite to the loan.[210]

Defendants moved to dismiss the complaint for failure to state a claim, maintaining that the broker's registration under the state's CSO statute, which imposed no limit on the amount of fees to be charged for the performance of credit services, prevented the fee as a matter of law from being characterized as interest.[211] The district court agreed and granted the motion, although it permitted the plaintiff to replead within thirty days. She did, but defendants renewed their motion. Once again, the court granted the defendants' motion to dismiss the complaint.[212]

205. *Lovick*, 378 F.3d at 437 (emphasis omitted) (alterations in original).

206. *Id.* She also filed suit against the general partners of Ritemoney and CPCWA. *Id.*

207. 18 U.S.C. § 1962(c) (1988).

208. *Lovick*, 378 F.3d 433.

209. *Id.* at 436.

210. *Id.*

211. Brief for Appellant, *supra* note 201, at 2.

212. *Lovick*, 378 F.3d at 437.

2. *The Decision*

On appeal, the Fifth Circuit reviewed a line of Texas cases examining the conditions under which a loan broker's fees might be attributed to the lender in connection with a usury claim.[213] Of those cases, many used language reminiscent of that used by the Texas court in *Cotton v. Cooper*.[214] From that language, the court acknowledged that Texas courts had considered several factors in determining whether a loan broker's fees constituted interest: (1) whether the fees paid by a borrower to a third party "constitute a condition imposed by the lender (or with the lender's knowledge)" for making the loan; (2) whether the lender has knowledge of the agent's fee; (3) whether the lender and broker maintain a general or special agency relationship; and (4) whether the lender benefits from the broker's fee in some non-incidental way.[215]

Yet the Fifth Circuit rejected the application of those cases to the facts at hand and held that the case law had been "supplanted" by the Texas Finance Code provisions regarding licensing or interest caps in 1975 and the Credit Services Organization Act (CSOA) in 1987.[216] However, it did so without citation to explicit authority for that proposition. Indeed, nowhere in the CSOA or its legislative history is there even a suggestion that its provisions should override the Finance Code or section 392.051(b), which explicitly prohibits the use of "any device, subterfuge, or pretense to evade the application of this section."[217] Instead, the court held that the "CSOA's silence on whether brokerage fees may be considered disguised interest" should not have been considered an "endorsement" of those fees and stated that the "CSOA expressly or impliedly permit[ted] the activities Lovick allege[d] CPCWA engaged in as a broker."[218]

Although section 392.051 provided a door through which the court could have exercised its discretion to permit discovery into the precise nature of the broker and lender's relationship, it refused to open it. While the dismissal closed the door on Betty Lovick,[219] it opened the floodgates to payday lenders' exploitation of a statutory scheme that was enacted to provide additional protection to consumers in an area

213. *Id.*

214. *See supra* notes 97–98 and accompanying text.

215. *Lovick*, 378 F.3d at 439–40.

216. *Id.* at 438–39.

217. TEX. FIN. CODE ANN. § 342.051(b) (2007).

218. *Lovick*, 378 F.3d at 443–44.

219. *Id.* at 444 (Jolly, J. dissenting) (dissenting on the grounds that the facts stated alleged sufficient ground to permit discovery on ultimate issues).

unrelated to the actual lending of money.[220] As discussed above, the CSOA was designed with a particular fact pattern in mind,[221] one that was completely unrelated to the facts present in the *Lovick* case.

3. *Still Another Head of Hydra*

Payday lenders did not waste any time in using the holding in *Lovick* to establish a new business model to relieve the tightened controls imposed by federal banking regulators on their partnerships with national banks. Without those partnerships, payday lenders in the state could revert to the previous payday model, legitimized by the legislature in 2000,[222] but doing so meant lower fees. Using *Lovick* as their guide, payday lenders in Texas reorganized and began to register as CSOs, enabling them to charge fees not limited under the state's small loan provisions, so long as they "arranged" loans that complied with the statutory interest ceilings.[223]

In the summer of 2005, a coalition of consumer advocacy groups called upon the state's credit commissioner and the Attorney General to "take action" against the practice.[224] Instead, six months later, the Attorney General issued its opinion approving it.[225] Based in part upon *Lovick*, the Attorney General concluded that payday lenders "arranging" for credit with third parties were entitled to act as CSOs, even though the fees were higher than otherwise permitted under state payday loan regulation.

The 2006 letter adopts a plain language approach and concludes that, because the statute failed to limit fees charged by the CSO for placement of a loan with a third-party lender, the payday lender licensed as a CSO that arranges for credit with a third party may charge fees even higher than those charged by payday lenders not licensed as CSOs.[226] Relying on *Lovick*, the 2006 letter is surprising for two reasons. First, the approach represents a marked change from the Attorney General's approach less than seven years earlier when it

220. *Id.*

221. *See supra* notes 165–198 and accompanying text.

222. *See supra* note 102 and accompanying text.

223. *EZCorp to Offer New Credit Services in EZMoney Stores in Texas*, AUSTIN BUS. J., July 15, 2005 (reporting that the Texas payday lender was reorganizing its 177 payday lending stores as registered CSOs). *See also* Chris Mahon, *Borrowing Against the Future*, BROWNSVILLE HERALD, Sept. 18, 2005, *available at* http://www.brownsvilleherald.com/ts_comments.php?id=67143_0_10_0_C.

224. Press Release, Ctr. for Pub. Policy Priorities, CPPP Calls on Texas Credit Commissioner and Attorney General to Take Action Against Payday Lenders Violating State Usury Laws (Sept. 16, 2005), *available at* http://www.cppp.org/files/2/s%20Policy%20Alert.pdf.

225. *See* McBee Letter, *supra* note 196.

226. *Id.*

embarked on a highly visible campaign to curtail payday lenders' activities in the state.[227] At that time, the CSOA had been on the books for more than ten years, yet the Attorney General took the position that payday lenders' operations, without complying with laws applicable to licensed lenders, violated not only the state's usury laws, but also the state's Deceptive Trade Practices Act and the Texas Debt Collection statute.[228] Second, although *Lovick* considered the application of CSO legislation to a consumer loan governed by the state's small loan laws, it did not examine the application of CSO legislation in the context of loans made pursuant to amendments to small loan laws that postdated CSO legislation by more than twelve years.[229] Thus, while the Attorney General's opinion extends *Lovick*'s rule to the payday loan, it does so by ignoring its reasoning that the more recently enacted statute governing the transaction at the heart of the issue is the one that should apply. Because Texas's payday loan legislation followed the CSOA by more than twelve years, the latter regulations, according to *Lovick*, should have trumped application of the CSOA to a payday loan transaction.

Not all agree with the Fifth Circuit's *Lovick* opinion and the Texas Attorney General on this issue. In June 2006, the Michigan Department of Labor and Economic Growth's Office of Financial and Insurance Services issued a bulletin concluding that payday lenders' use of the CSO model would run afoul of the state's usury laws. It reasoned that, because the state had enacted legislation specifically directed at payday lenders more recently than it had regulated CSOs, a payday lender's attempts to register as a CSO was "an activity that the Legislature intended to be governed by" the state's payday loan legislation.[230] Further, because it was the "more recent statute addressing these kinds of transactions, that law govern[ed]."[231] In March 2007, a bill was introduced in the Texas legislature that would expressly prohibit a CSO from associating with a lender to make the kind of transaction at issue in *Lovick*, though it died in committee when the legislative session ended in June.[232]

---

227. *See* Cornyn Press Release, *supra* note 107.

228. *Id.*

229. *Id.*

230. *Id.*

231. LINDA A. WATTERS, MICH. DEPT. OF LABOR & ECONOMIC GROWTH, OFFICE OF FIN. & INS. SERVS., BULL. NO. 2006-06-CF (June 21, 2006).

232. S.B. 857, 80th Leg., Reg. Sess. (Tex. 2007).

4. *The Consequences*

On the one hand, *Lovick*'s extension can be seen as an unwarranted extension of statutory law in an area that the legislature did not intend to cover. On the other, it can be seen as an example of courts shifting away from their traditional role in protecting consumers from transactions designed to avoid rate regulation. The latter is consistent with Professor Rashmi Dyal-Rand's description of courts' use of an "enlightened borrower" paradigm analogous to the contract rules governing credit cards.[233]

A similar pattern has played out in the area of tenants' rights. There, courts led the way for reforms to protect residential tenants from the harsh property rules that historically governed their relationship with landlords, only to have those protections buried in complicated regulatory schemes that often provide a safe harbor for landlords while making it nearly impossible for tenants to assert their rights.[234]

What does the payday lender's use of the CSO model mean for consumers? The most obvious consequence is higher fees for consumers, increasing the cost of credit and contributing to the cycle of debt that is often difficult to break. Perhaps more troubling is the potential for deception as increasing numbers of consumers burdened by debt find themselves seeking the services of credit counseling firms, whether as a prerequisite to bankruptcy relief or as an alternative to it. Although the Bankruptcy Code requires debtors to obtain services from approved nonprofit credit counselors, nonprofit status is not a guarantee of legitimacy.[235] While such firms are not subject to regulation under CSO legislation,[236] their presence in a market already populated by overreaching and deception only compounds the potential for harm to consumers.

V. Taming the Beast

Undoubtedly, payday lenders' transformation into CSOs is their most recent attempt to avoid regulation of the amount of interest charged for a payday loan; their own promotional literature makes

233. Dyal-Chand, *supra* note 87, at 305.

234. Javins v. First Nat'l Realty Corp., 428 F.2d 1071, 1073 n.3 (D.C. Cir. 1970); *see also* Mary B. Spector, *Tenants' Rights, Procedural Wrongs: The Summary Eviction and the Need for Reform*, 46 Wayne L. Rev. 135, 209 (2000).

235. *See supra* notes 170–172 and accompanying text.

236. *See supra* notes 196–198 and accompanying text.

that clear.[237] Historically, courts have demonstrated a willingness to look beyond the form of a loan transaction to determine faithful adherence to the rules governing its substance. But, faced with an ever-growing body of statutes and regulations that struggles to keep up with the creativity of the industry it regulates, courts are increasingly limited to determining technical compliance with those rules. The industry's resilience, as demonstrated by the payday lender's newest incarnation in the form of the CSO, is cause for concern. Despite efforts at the federal and state levels to subject payday lenders to closer scrutiny, it appears that the use of the credit services model has provided another means for the industry to circumvent laws designed to regulate them.

Federal banking regulators have already heeded their own advice by tightening controls on national banks' ability to partner with payday lenders. Others, including the Department of Defense, advocate increased consumer education and disclosure, including plain language forms and meaningful comparisons of the cost of credit.[238] While such efforts can have a positive impact on consumers, they will likely be insufficient and ineffective.[239] Still others, such as the IRS and, to a lesser extent, the Office of the Bankruptcy Trustee, have some supervisory authority over CSOs and credit counselors, but their primary responsibilities fall outside the scope of most lending regulators.

An important first step occurred on October 1, 2007, when the Talent Amendment to the Servicemembers Civil Relief Act became law, capped interest rates,[240] and limited rollovers on payday loans for military personnel and their families.[241] Its provisions extend to other forms of unsecured consumer credit and adopt several other consumer protections recommended by the Department of Defense as part of a comprehensive approach to tackle lending practices to military personnel and their families:[242] limiting fees and rollovers; prohibiting

---

237. Press Release, Dollar Fin. Corp., Dollar Financial Corp. Announces Credit Services Organization Loan Product in Texas Stores (June 23, 2006), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=177357&p=irol-news Article&ID=875753&highlight=.

238. *See* DoD REPORT, *supra* note 17, at 50 & app. 4 (describing the Department's strategy to increase personnel awareness, reduce dependence on credit, and increase protection against predatory lenders); PETERSON, *supra* note 16.

239. Ray Prushnok, N.M. Pub. Interest Research Group Educ. Fund, *Payday, Mayday! Payday and Title Lender Compliance to Signage and Brochure Regulations* (Mar. 2002) (finding that less than 35% of lenders were in full compliance with disclosure requirements); *see also* Ronald J. Mann & James Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855 (2007).

240. 10 U.S.C. § 987(b) (2007).

241. § 987(e)(1),

242. *See* DoD REPORT, *supra* note 17, at 50–52.

loans secured by a vehicle's title when the loans are not used to purchase the vehicle;[243] and forbidding mandatory arbitration,[244] waiver of rights,[245] and prepayment penalty provisions.[246]

These protections are part of a comprehensive strategy to improve servicemembers' "financial readiness."[247] Yet the financial stressors that burden military families[248] burden all young, inexperienced borrowers with steady jobs and little money saved. Low morale, poor quality of life, and impaired job performance caused by excessive consumer debt burden Americans without regard to their occupation.

Even with the implementation of all of its recommendations, the Department of Defense conceded that voluntary compliance by payday lenders could not be expected. Sustained enforcement by state and federal agencies is a critical element in effectively monitoring compliance. Just as Hercules employed multiple strategies to slay the Hydra, federal and state lawmakers must do the same to reign in payday lenders. Simply capping interest rates and limiting rollovers or providing uniform price disclosures is not enough. As the brief life of payday lending makes clear, such regulations have provided little more than a temporary fix and appear also to have neutralized courts' ability to protect consumers. New regulations must include not only meaningful preservation of consumer rights—including prohibitions against mandatory arbitration and waiver of consumers' rights, as provided in the Talent Amendment—they must also provide residual controls that enable courts to exercise their historic power to look behind transactions to determine their substance. Doing so is essential to taming the payday loan beast.

243. 10 U.S.C. § 987(e)(5).

244. § 987(e)(3).

245. § 987(e)(2).

246. § 987(e)(7). It also prohibits creditors from imposing unreasonable notice provisions as a condition to legal action. § 987(e)(4).

247. Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rules, 32 C.F.R. § 232, 72 Fed. Reg. 50,580.

248. *Id.*