"WARNING: PREDATORY LENDER"—A PROPOSAL FOR CANDID PREDATORY SMALL LOAN ORDINANCES

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Abstract

Over a hundred different local governments around the country have adopted ordinances restricting high cost, small loans. This trend reflects the solid majority of the American public that opposes the legality of triple-digit interest rate loans and the long historical tradition of treating "payday" and car-title lending as a serious civil offense or even a crime. Nevertheless, perhaps owing to limits on municipal power, local payday lending law has generated relatively little scholarship or commentary. This paper describes the existing local law governing small, high-cost consumer loans and proposes a more emphatic ordinance that better reflects the policy judgment of many local leaders and a solid majority of the America public. In particular, this paper (1) introduces the historical background of regulation of usurious lending; (2) analyzes the recent growth in local ordinances attempting to control small, high-cost loans; (3) discusses the evidence of market failure in the small high-cost loan market; (4) proposes a model ordinance requiring that lenders who offer loans in excess of 45% per annum display a cautionary message that reads: "Warning: Predatory Lender," on their street, storefront, and other on-premises signs; and, (5) argues that the well-established municipal authority over signage provides a solid statutory and constitutional basis for such a law. An appendix with a model ordinance suitable for adoption by most local governments follows.

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I. INTRODUCTION

While the heated academic debate over the wisdom of tolerating triple-digit interest-rate consumer finance continues, there is one way in which payday and car title loans remain relatively uncontroversial. Today, an overwhelming majority of Americans—about three out of four—support traditional usury law prohibiting predatory triple digit interest rate loans.[1] In every public ballot referendum ever conducted on the subject, Americans have overwhelmingly voted in favor of traditional usury limits on the interest rates of consumer loans.[2] Perhaps surprising in an era of polarized

[1] Center for Responsible Lending, *Congress Should Cap Interest Rates: Survey Confirms Public Support for Cracking Down on High-Cost Lending,* CRL Research Brief, March 2009, available at: http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf ("Three out of four Americans who expressed an opinion think that Congress should cap interest rates at some level. 72% think that the annual interest rate cap should be no higher than 36% annually. Only one quarter of those who expressed an opinion think Congress should not cap interest rates at all."). The telephone survey reached 1004 adults in the continental U.S. CRL weighted the sample by age, sex, geographic region, and race to suggesting a 95% chance that the survey results are accurate within 2%. *Id. See also* Center for Policy Entrepreneurship, Poll on Payday Lending Legislation, Memorandum, February 15, 2008, available at: http://www.c-pe.org/download/PaydayLendingReform/PollPaydayLending.pdf (Weighted sample of 500 Colorado voters found "74% of respondents are in favor of proposed legislation that will set a cap of 36% on the interest and fees that a company can charge for payday loans."); Kentucky Coalition for Responsible Lending, Survey Says: Kentucky Voters Support 36% APR Cap, Press Release on file with author, February 7, 2011 (Survey of "Nearly 400 voters from 179 cities and towns across Kentucky" found "73% of the Commonwealth's voters support a 36% APR cap on payday loans").

[2] Ballot measures on usury limits have occurred in Arizona, Montana, and Ohio. The public voted overwhelmingly in favor of usury limits in all three states. Marian McClure, *Let's Make Sure the Sun Sets on Arizona Payday Loans*, Arizona Republic, November 21, 2009, B5 ("60 percent of Arizona voters soundly rejected 400 percent annual interest rates on payday loans, when 1.2 million Arizonans rejected the payday lenders' Proposition 200. The lenders spent more than $14 million trying to fool the people. The voters saw through their scam. "); Editorial, Great Falls Tribune (Great Falls, MT), January 6, 2011, ("Ballot Initiative 164, which took effect Jan. 1, capped the annual interest rates on payday and car

politics, usurious lenders have lost these ballot measures in red, blue, and swing states.[3] These votes against predatory credit pricing are even more emphatic when considered in light of massive industry advertising campaigns that nonetheless utterly failed to persuade voters.[4]

This broad-based support for usury limits is built upon American history, tradition, and culture. For nearly three hundred years, American states were nearly unanimous in their prohibition of usurious lending through double or even single digit interest rate caps.[5] Every signatory to the Declaration of Independence returned to Colonies that aggressively capped interest rates.[6] When the "greatest generation" assumed the mantle of public leadership after emerging from the Great Depression and the Second World War, all fifty states capped interest rates on small consumer loans with median limit of 36% per annum.[7] For generations, the Federal Bureau of Investigation used undercover investigations to track down usurious lenders and incarcerate them.[8] The American public's skepticism has at least in part grown out of a moral view, grounded in the prevailing Christian faith of most Americans, that the taking of excessive interest is a grave and punishable sin.[9] While not all subscribe to this moral value, it is

title loans at 36 percent . . . . The measure passed with 72 percent of the vote statewide. It won in every county and House district . . ."); Editorial, *Ohio Voters Prove that a Good Idea Can Beat $22 Million*, Akron Beacon Journal, November 6, 2008 ("Voters handed the industry a deservedly humiliating defeat, rejecting one of the slickest and most misleading campaigns in the state this election season by a ratio of roughly 2-to-1. The defeat of the lenders is particularly gratifying, as their efforts carefully concealed the industry's goal to regain the license to charge excessive interest rates to borrowers desperate for quick loans.").

[3] *Id. See also* Center for Policy Entrepreneurship, *supra* note 1 (Colorado telephone survey finding "overwhelming support, regardless of political affiliation, region, gender, income, education level, ethnicity and age. 83% of Democrats,72% of Unaffiliated and 68% of Republicans favored new caps on payday loans.").

[4] *See, e.g.,* Steve Hoffman, *Battle of the Ballot Issues*, Akron Beacon Journal, April 28, 2011, A6 (voters upheld the Ohio interest rate cap "seeing through an incredible barrage of misleading television ads.").

[5] *See infra* note X and accompanying text.

[6] RANSOM H. TYLER, A TREATISE ON THE LAW OF USURY, PAWNS OR PLEDGES, AND MARITIME LOANS 50 (1891).

[7] TOM BROKAW, THE GREATEST GENERATION (1998); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion and American Credit Pricing Limits*, 92 MINNESOTA LAW REVIEW 1110, 1138 (2008).

[8] *See* DENNIS FITZGERALD, INFORMANTS AND UNDERCOVER INVESTIGATIONS: A PRACTICAL GUIDE TO LAW, POLICY, AND PROCEDURE 228-29 (2007).

[9] About a dozen Biblical passages suggest that usurious lending, especially to the poor, is a grave sin. For example, the first reference to usury in the Bible states: "If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shall thou lay upon him usury." Exodus 22:25 (King James). The Bible also intimates a harsh punishment for usurers: "Hath given forth upon usury, and hath taken increase; shall he then live? he shall not live; he hath done all these abominations; he shall surely die; his

clear that America reached the zenith of its power, wealth, and international prestige following centuries of aggressive enforcement of usury law and a robust thrift ethic.

Nevertheless, in recent decades federal and state usury law has become more lax and less transparent. The Supreme Court's decision in *Marquette Nat'l Bank v. First Omaha Serv. Corp.*[10] adopted a historically controversial interpretation of a Civil War era banking law that allowed national banks to export high interest rate loans from deregulated states to consumers living in traditionally regulated states.[11] This ignited a race-to-the-bottom where state legislatures were pressured to raise or eliminate usury limits in order to avoid "discriminating" against local banks.[12] Moreover, high inflation in the late 1970s raised lenders' cost of funds, making profitable consumer lending temporarily more difficult within traditional interest rate caps.[13] This unusual macroeconomic pressure led some states to relax or eliminate their usury limits.[14] More recently, nationally organized, well funded, and narrowly focused state-by-state lobbying campaigns have persuaded many state legislators serving on key financial services committees to adopt special licensing statues authorizing non-depositary finance companies to make triple digit interest rate payday and car title loans. As a result, usury limits no longer prohibit these loans for banks in all fifty states and for non-depositary lenders in about thirty-five states.

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blood shall be upon him." Ezekiel, 18:8-17. *See also* Ezekiel 22:16-22; Jeremiah, 15:10; John 2:14-15; Leviticus, 25:35-37; Luke 6:33-35; Mathew 5:42; Neh. 5:1-13; Proverbs 28: 6-9; Psalm 15: 1, 4-5; Luke 6:31-36; John 2:14-15. The Biblical condemnation of usurious lenders is closely related to the deep and consistent message of the Bible demanding kind and just treatment of poor and vulnerable members of society. Deuteronomy demands "thou shalt not oppress an hired servant that is poor and needy, whether he be of thy brethren, or of thy strangers that are in thy land within thy gates." Deut., 24:14. The Bible commands Christians to "[e]xecute true judgment, and shew mercy and compassion every man to his brother; and oppress not the widow, nor the fatherless, the stranger, nor the poor…." Zechariah 7:9-10. For summary and analysis of post-reformation Christian theology of usury *see* Steven Graves M. Graves and Christopher L. Peterson, *Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation*, 57 CATH. L. REV. 636, 648-654 (2008); Charles H. George, *English Calvinist Opinion on Usury, 1600-1640*, 18 J. OF THE HIST. OF IDEAS 455 (1957); BENJAMIN N. NELSON, THE IDEA OF USURY: FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD (1949). For pre-reformation analysis of Christian usury theology *see* Brian McCall, *Unprofitable Lending: Modern Credit Regulation and the Lost Theory of Usury*, 30 CARDOZO L. REV. 549 (2008); ODD LANGHOLM, THE ARISTOTELIAN ANALYSIS OF USURY (1985); JOHN T. NOONAN, THE SCHOLASTIC ANALYSIS OF USURY (1957).

[10] 439 U.S. 299 (1978).

[11] James J. White, *the Usury Trompe l'Oleil,* 51 S.C. L.REV. 445, 465 (2000).

[12] Peter A. Alces and Michael M. Greenfield, *They Can Do What!? Limitations on the Use of Change-of-TermsClauses*, 26 GA. ST. U. L. REV. 1099, 1128-30 (2010).

[13] PAUL R. BEARES, CONSUMER LENDING 12 (2d ed. 1992)

[14] *Id.*

Still, while federal and state law has unraveled, many local leaders around the country continue to ardently support the traditionally restrictive American moral and legal view usurious lending to families. Responding to the vacuum in usury law, over a hundred different local governments around the country have adopted ordinances attempting to restrict payday and car title lending.[15] Although this growing trend has generated relatively little national press or scholarly commentary,[16] it appears to reflect the great majority of the American public that supports the illegality of triple-digit interest rate loans and the long historical tradition of treating payday and car title lending as a serious civil offense, and in many states, a crime.

This Article explores the growing trend of municipal ordinances and resolutions attempting to inhibit payday and car title lending. In particular, Part I introduces the historical background of usurious lending regulation that provides the context within which current local law must be understood. Part II describes and analyzes the growing number of local ordinances controlling small, high cost loans and suggests that, owing to the limits on local power, current local law has had very limited success in meeting its own objectives. Instead, Part III proposes a model ordinance requiring that lenders offering loans with annual percentage rates in excess of 45% display a cautionary message that reads "Warning: Predatory Lender," on their street, storefront, and other on-premises signs. Part IV argues that the well-established municipal authority over signage provides a solid constitutional and statutory basis for such a law. Part V concludes and is followed by an appendix with a model ordinance suitable for adoption by most local governments.

II. THE LAW OF PREDATORY SMALL LOANS IN HISTORICAL CONTEXT

All of the thirteen original American states aggressively regulated consumer loans with annual interest rate caps of between eight and five percent, with six percent being most typical.[17] European colonists had imported these price limits from England, which at the time capped interest

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[15] Unpublished database on file with author.

[16] Two notable exceptions include Kelly Grifith, Linda Hilton, and Lynn Drysdale, *Controlling the Growth of Payday Lending Through Local Ordinances and Resolutions: A Guide for Advocacy Groups and Government Officials*, Unpublished Manuscript, November 2007; Amy Lavine, *Zoning Out Payday Loan Stores and Other Alternative Financial Services Providers*, Unpublished Manuscript (Albany Law School Working Paper Series, July 2011), *available at* http://ssrn.com/abstract=1885197.

[17] Tyler, *supra* note X, at 50-3.; Peterson, Salience Distortion, *supra* note X, at 1117-18.

rates with a simple nominal annual rate of five percent.[18] Both American and English usury law grew out of both Protestant and Catholic theology on the moral limits of acceptable lending practices.[19] Early American leaders held usurious lenders in contempt.[20]

At the beginning of the twentieth century, most states in the Union began modifying their interest rate caps to allow more expensive consumer loans. The change reflected the evolving consumer culture of an industrializing America.[21] As more Americans earned their income through relatively stable salaries, rather than seasonal agricultural income, managing a household's needs through the use of moderately priced consumer finance became more culturally acceptable.[22] Throughout most of the twentieth century "Small Loan Acts" were the primary consumer financial protection law in the country. Most states based their laws on a model statute sponsored by the Russell Sage Foundation, a charitable foundation created by the widow of a railroad baron.[23] State Small Loan Acts licensed finance companies authorizing them to charge interest rates ranging from 18 to 42 percent per year, with 36% being typical.[24] Social reformers that lobbied for these rules argued that ordinary citizens ought to have access to credit, and that higher interest rate limits in this range were still within a price zone where borrowers could benefit from the credit and have a reasonable opportunity to repay.[25] These low double-digit interest rate usury limits

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18. Act to Reduce the Rate of Interest, 1713, 12 Ann., c. 16 (Eng.).

19. Stephen M. Graves and Christopher L. Peterson, *Usury Law and the Christian Right: Religious Political Power and the Geography of American "Payday" Lending Regulation* 57 CATHOLIC U. L. REV. 637, 648-55 (2008). Protestant reformers, such as Martin Luther, believed that interest rates of five to six percent were moral, and that even 8% was permissible in some cases. NORMAN JONES, GOD AND THE MONEYLENDERS: USURY AND LAW IN EARLY MODERN ENGLAND 47–48, 77 (1989). Moreover, after centuries of prohibiting any interest whatsoever, Pope Paul II gave his tacit approval to charitable pawnshops to charge a 6% simple nominal annual rate in 1461. *Id.* at 76.

[20] *See infra* notes X-X and accompanying text.

[21] LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 134–35, 143 (1999).

[22] *Id.*

[23] *See* ROGER S. BARRETT, COMPILATION OF CONSUMER FINANCE LAWS AND OF USURY, SALES FINANCE, AND ALLIED LAWS, at xiii (1952). Many of the states that did not use the Russell Sage Foundation model law relied on statutes that legalized "Morris Plan" lending, which facilitated higher real prices by using an add-on interest rate, rather than traditional simple actuarial interest rates. *See* EVANS CLARK, FINANCING THE CONSUMER 68–72 (1930); FRED H. CLARKSON ET AL., CONSUMER CREDIT AND ITS USES 32 (Charles O. Hardy ed., 1938); PETER W. HERZOG, THE MORRIS PLAN OF INDUSTRIAL BANKING *passim* (1928); NAT'L CONSUMER LAW CTR., THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 2.2.3.1, at 39 (1995).

[24] Peterson, *Salience Distortion, supra* note X, at 1120, 1145.

[25] IRVING S. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 112–29. (1970).

allowed the development of credit cards and retail installment loan purchasing that became a staple of middle class America.

By the 1960s, every state in the union had some form of a small loan law on the books.[26] A handful of states had exceptions or ambiguity in their usury limits that allowed higher interest rates by historical standards. But nonetheless, a typical contemporary payday and car title loan continued to be illegal in every state of the Republic. Although today payday and car title lenders chafe at the term "predatory lender," with relatively few exceptions, these loans were illegal and often regarded as serious crimes for over three hundred years of American history.[27] From America's emergence as an industrial power at the turn of the twentieth century through the apogee of our hegemonic leader, the premier bastion of consumer protection law were state Small Loan Acts championed by the Russell Sage Foundation.

The United States Supreme court was the first government institution to meaningfully disrupt the centuries old tradition of American usury law. In the 1978 case of *Marquette National Bank v. First of Omaha Service Corp*.[28] the Court confronted for the first time the question of what state usury law applies when a national bank lends money to a consumer across state lines: should the law of the bank's home state or the law of the consumer's home state apply?[29] Turning to National Bank Act, a statute adopted in 1864,[30] the Supreme Court concluded that Congress had

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[26] Peterson, *Salience Distortion*, *supra* note X, at 1138.

[27] Peterson, S*alience Distortion, supra* note X, at 1119; SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES at 428-29 (3d ed. 1996). *See, e.g.*, Com. v. Morris, 176 Mass. 19, 56 N.E. 896 (1900) (holding Massachusetts' criminal penalties of sixty days incarceration for violation of 12 percent simple nominal annual usury limit was constitutional); Ex parte Berger, 193 Mo. 16, 90 S.W. 759 (1905) (holding Missouri criminal penalties of 30 to 90 days incarceration for violation of 12 percent annual interest rate limit was constitutional); Jarvis v. State, 69 Ga. App. 326, 25 S.E.2d 100, 101 (1943) (upholding criminal conviction of for making an approximately 312% annual interest rate salary loan in violation of Georgia's small loan usury limit); Beasley v. Coleman, 136 Fla. 393, 180 So. 625 (1938) (quashing habeas corpus petition that challenged conviction for making an approximately 520% interest rate salary loan in violation of Florida's statute imposing up to six months incarceration for usury); People v. Lombardo, 61 N.Y.2d 97, 472 N.Y.S.2d 589, 460 N.E.2d 1074 (1984) (holding New York statute defining lending in excess of 25% annual interest as a class C felony was not unconstitutionally vague). Some states temporarily experimented with eliminating their usury laws for short periods in the 19th century. George Holmes, *Usury Law in Practice and in Psycholog*y, 7 POL'Y SCI. Q. 431, 432 (1892). Moreover, in the "wild west" it would often take a few years before newly formed states and territories would adopt usury limits. *Id.* at 436-442.

28. 439 U.S. 299 (1978).

29. *Id.* at 309–13.

30. National Bank Act, ch. 106, 13 Stat. 99, 108 (1864) (codified as amended at 12 U.S.C. § 85 (2000)).

intended the law of the bank's home state to apply.[31] While seemingly innocuous, this holding gave a handful of rural states the opportunity to deregulate every other state's usury limits with respect to federally chartered banks.[32] Recognizing the opportunity to attract banking jobs to their states, South Dakota and Delaware quickly repealed their interest rate caps and encouraged national banks to open subsidiaries headquartered there to "export" the nonexistence of an interest rate cap to consumers in other states.[33]

For their part, banks chartered by state governments were envious of their national bank competitors' newfound power and immediately began lobbying Congress for equal treatment.[34] While Congress did not explicitly authorize the "exporting" model of deregulation, it did finessed the issue by granting state banks whatever power already held by national banks.[35] As a result, state legislatures became powerless to constrain the interest rates charged by any bank, whether federal or state chartered, that happened to claim its headquarters in South Dakota or Delaware.[36] Seeing no point in punishing their local financial institutions, virtually every other state in the union decided to pass "parity laws" that gave their own local depository institutions the right to charge whatever interest rate South Dakota and Delaware banks could import into their jurisdictions *via* federal law.[37] The

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31. *Marquette Nat'l Bank*, 439 U.S. at 309–13; *see also* NAT'L CONSUMER LAW CTR., *supra* note X, at § 3.4.5.1.1 (questioning the historical accuracy of *Marquette*); BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR 725–34 (1957) (detailing the events that led to the enactment of the National Bank Act).

32. *See* DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 10:29, at 10-47 to -53 (2002); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 36–37 (2005); Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 66–67 (2004); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 619–20 (2004); William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 UTAH L. REV. 1009, 1010–11.

33. White, *supra* note X, at 447–48, 464–65; Schiltz, *supra* note X, at 618–20.

34. Howard J. Finkelstein, *Most Favored Lender Status for Insured Banks*, 42 BUS. LAW. 915, 918 (1987).

35. 12 U.S.C. §§ 1463(g), 1831a(b), 1831d(a) (2012); *see also* Federal Deposit Insurance Corporation Notice of General Counsel's Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17 1998) (interpreting section 27 of the Federal Deposit Insurance Act as providing state-chartered, federally insured banks the same interest rate exporting powers as those granted to national banks under section 85 of the National Bank Act).

36. NAT'L CONSUMER LAW CTR., *supra* note X, at § 3.4.5.1.1, at 74–75 (discussing the effect of "sister-state" preemption).

37. Christian Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 368 (1995); John J.

end result was what James White called a *trompe l'oleil*—a grand illusion.[38] Every state in the union, save two, had relatively aggressive usury law on the books, but these laws no longer applied to any bank in the country.

That being said, at the beginning of the 1980s, state usury limits did still apply to non-bank lenders. Finance companies, car dealerships, retailers, and even mafia loan sharks were still legally required to comply with the traditional usury limits. [39] Non-depositary finance companies resented the special treatment of banks and in many states began agitating for their own special exceptions to the old small loan laws. High inflation and prevailing interest rates in the late 1970s raised lenders' cost of funds, made these lobbying efforts, at least temporarily, more persuasive.[40] With prevailing prime interest rates in the double digit range, making profitable consumer loans was difficult under some of the lower traditional interest rate caps. This unusual macroeconomic pressure along with well funded state-by-state lobbying campaigns persuaded many state legislatures to adopt more expansive usury limit exceptions.

While payday lending had historical forebears both in the U.S. and around the world, the industry reinvented itself in this period by deferring the deposit of borrowers' personal checks.[41] In a typical transaction the borrower would write a personal check to the payday lender, but date the check for about two weeks in the future.[42] The lender would, in turn, would "cash" the check by giving the borrower the face amount of the check less a finance charge. After two weeks went by, the borrower could buy back the check by bringing cash into the payday lender's store, or simply allow the lender to deposit the check. In many states, payday lenders insisted they did not make loans, but rather were simply cashing checks.[43] In other states, payday lenders teamed up with a handful of banks to "rent" the bank's *Marquette* powers.[44] The payday lender would do the marketing, intake,

Schroeder, *"Duel" Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 IND. L. REV. 197, 207 (2003).

38. *See* White, *supra* note 33, at 445–48.

[39] Peterson, *Salience Distortion, supra* note X, at 1138-39.

[40] Bears, *supra* note X, at 12.

[41] ROBERT MAYER, QUICK CASH: THE STORY OF THE LOAN SHARK (2010).

[42] JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 30 (1994).

[43] *See, e.g.,* Hamilton v. HLT Check Exchange, LLP, 987 F. Supp. 953, 955 (E.D. Ky. 1997) (rejecting payday lender's argument that "it was not charging interest but only service fees for cashing checks.")

[44] Elizabeth Willoughby, Recent Development, *Bankwest v. Baker: Is it a Mayday for Payday Lenders in Rent-a-Charter Arrangements?,* 9 N.C. BANKING INST. (2005); Michael Bertics, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 146 (2005).

collections, but would pay a fee to a bank for permission to nominally make the loan in the name of the bank.[45] Eventually, the federal banking regulators cracked down on these practices by issuing guidance that deferred check cashing is a form of lending governed by the Truth in Lending Act[46] and that "charter renting" to avoid usury limits is an unsafe and unsound banking practice.[47] But in the meantime, the payday lending industry had developed a critical mass, with aggressive trade associations, and highly effective lobbyists. In many states payday lenders supported weak legislation that purported to "regulate" payday lending, but actually had little substantive content and primarily served to legitimize hitherto illegal or even criminal loans. Indeed with average interest rates of around 400 percent, payday loans were actually much more expensive than the old *mafia* loan sharks that typically charged a relatively mild 250 percent.[48]

With the traditional moral and legal limits crumbling in many states, the payday lending industry exploded. In comparison to the hundreds of years of stable, thrift-oriented American consumer finance, a massive usury industry sprang up almost overnight. In the early 1990s, payday lending was a tiny peripheral component of the financial services industry with only a few hundred locations nationwide.[49] But in the late 1990s and early 2000s, the number of locations around the country rapidly grew. For example, after Mississippi legitimized payday lending by "regulating" it in 1998, the

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[45] *See* People v. County Bank of Rehoboth Beach, Delaware, 2007 WL 4127132 (N.Y.A.D. 3 Dept. 2007); Jenkins v. First Am. Cash Advance of Georgia, 400 F.3d 597 (11th Cir. 2007).

[46] Board of Governors of the Federal Reserve System, Final Rule, Regulation Z; Docket No. R-1050, March 24, 2000, available at: http://www.federalreserve.gov/boarddocs/press/boardacts/2000/20000324/attachment.pdf.

[47] Office of the Comptroller of the Currency, OCC Consent Order No. 2001-104 (January 3, 2002), *available at* http://www.occ.treas.gov/ftp/eas/ea2001-104.pdf; OCC Consent Order No. 2002-93 (October 29, 2002), *available at* http://www.occ.treas.gov/ftp/eas/Goleta%20Consent.pdf; Federal Deposit Insurance Corporation, Guidelines for Payday Lending, Financial Institution Letter, February 25, 2005, available at: http://www.fdic.gov/news/news/financial/2005/fil1405a.html#foot1; Ben Jackson, *FDIC Actions Indicate Less Tolerant Stance on Payday*, Am. Banker, March 6, 2006, at 1.

[48] *Compare* Keith Ernst, John Farris, and Uriah King, Quantifying the Economic Cost of Predatory Payday Lending: A report from the Center for Responsible Lending, at 3 n.4 (February 24, 2004) *available at:* http://cfsinnovation.com/system/files/imported/managed_documents/crlpaydaylendingstudy.pdf; *Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 COLUM. L. REV. 167. 167 (1966).

49. Federal Deposit Insurance Corporation, *An Update on Emerging Issues in Banking: Payday Lending*, Jan. 29, 2003, http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html ("Industry analysts estimate that the number of payday loan offices nationwide increased from less than 500 in the early 1990's to approximately 12,000 in 2002, with continued growth expected.").

number of payday lenders in the state quickly tripled.[50] North Carolina payday lending outlets roughly quadrupled in four years, growing from 307 in 1997 to 1204 in 2000.[51] Wyoming payday lenders almost tripled between 1996 and 1997.[52] Payday lending outlets quintupled in Salt Lake City between 1994 and 2000.[53] In Iowa payday lenders locations grew eightfold in only two years.[54] Nationwide, the number of payday lender locations more than doubled from 10,000 to 22,000 between 2000 and 2004 alone.[55] Today, payday lenders, and their secured creditor cousins, the car title lenders, are no longer fringe businesses. Rather they are a powerful, multi-billion dollar industry that has completely transformed lower and middle income American consumer finance.

Despite the usury industry's formidable commitments to campaign finance contributions and government relations, the momentum in continuing legislative battles appears to have died out. In recent years, several states have re-imposed more traditional usury limits. North Carolina led this trend by allowing its payday lending authorization statute to expire under a sunset provision in 2005.[56] Georgia,[57] New Hampshire,[58] Oregon,[59] and the District of Columbia[60] have taken similar measures. In Arkansas,

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[50] Jimmie E. Gates, *Check-Cashing Businesses Rolling out the Dough*, CLARION LEDGER, Feb. 6, 2005.

[51] OFFICE OF THE COMM'R OF BANKS, REPORT TO THE GENERAL ASSEMBLY ON PAYDAY LENDING, Feb. 22, 2001, at 5.

[52] Consumer Federation of America, The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry 3 (Nov. 1998) *available at:* http://www.consumerfed.org/The_Growth_of_Legal_Loan_Sharking_1998.pdf.

[53] Christopher L. Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV. 543, 560-61.

[54] Jean Ann Fox, The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry, Consumer Federation of America, November 1998, *available at*: http://www.in.gov/dfi/2366.htm ("In two years, Iowa payday lenders increased from eight to sixty-four. Louisiana licenses 345 lenders").

55. Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 2 (FDIC Ctr. for Fin. Research, Working Paper No. 2005–09, 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_ 2005-09_Flannery_Samolyk.pdf

[56] Press Release, N.C. Dep't of Justice, Payday Lending on the Way Out in N.C. (Mar. 1, 2006), *available at* http://www.ncdoj.comJDocumentStreamerClient?directory=PressReleases/&file=paydaylenders3.06.pdf.

[57] GA. CODE ANN. § 7-3-14.

[58] N.H. REV. STAT. ANN § 399-A:13 § XX ("The annual percentage rate on a payday loan shall be no more than 36 percent per year.").

[59] OR. REV. STAT. § 725.622.

[60] D.C. CODE § 28-3301–3303

the state Supreme Court used the state's constitutional interest rate cap to overturn legislation authorizing payday lending.[61] In Ohio, Arizona, and Montana the public has voted to reestablish traditional price limits on state ballot measures.[62] At the federal level, Congress created the first national usury limit capping interest rates chargeable to military service members at 36% per year.[63] And, of course, several states, particularly in the northeast, have maintained a steady commitment to traditional usury limits.[64] Still, in many more states usurious lenders have managed to forestall a return to traditional American law with a variety of cosmetic rules that do not provide meaningful consumer protection. It is these states which have set the stage for a growing trend of municipal and county leadership.

II. PREDATORY IS AS PREDATORY DOES: INEFFICIENCY IN CONSUMER FINANCE MARKETS

The government relations and marketing wings of financial services companies have long talked at cross purposes. When consumer financial services companies speak to legislatures, regulators, and courts they tend to extol faith in the ability of financial markets to resolve to efficient outcomes. The hallmark of this consumer finance advocacy has always been the Adam Smith's "invisible hand" guiding allocation of resources to a collectively optimal outcome through individuals' rational, self interested decisions. However, when the sales and marketing wings of financial services firms communicate with prospective borrowers, the unmotivated invisible hand is replaced by a calculated effort to persuade and sometimes

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[61] McGhee v. Arkansas State Bd. Of Collection Agencies, 289 S.W.3d 18, 27 (Ark. 2008) ("Because the Act so clearly authorizes usurious interest rates, it cannot stand."). *See also* Adam L. Bodeker, *McGhee v. Arkansas State Board of Collection Agencies: Arkansas Shows Predatory Lenders the Door*, 63 ARK. L. REV. 645, 659 (2010) ("Because the Arkansas Check-cashers Act clearly authorized loans charging usurious interest rates in violation of the usury provisions of the Arkansas Constitution, the court held the Act unconstitutional in its entirety.").

[62] *See infra* note X. Despite these referendums, the payday lending industry is actively attempting to circumvent public will in Ohio and Arizona by exploiting loopholes not closed in the precise wording of the ballot measures. *See* Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAP. L. REV. 23, 74-75 (2010).

[63] John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a). 120 Stat. 2083,2266 (2006) (to be codified at 10 U.S.C. § 987(b) ("A creditor . . . may not impose an annual percentage rate of Interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member.").

[64] CONN. GEN. STAT. § 36.-563 (2004); MD. CODE ANN., COM. LAW § 12-306(0)(2)(i); MASS. GEN. LAWS. ch. 140, § 100 (Supp. 2007); 209 MASS. CODE REGS. 26.01 (2007); N.J.STAT. ANN § 2C;21-19; N.Y. PENAL LAW § 190.40; 7 PA. CONS. STAT. ANN. § 6213; VT. STAT. ANN. tit. 9, § 410 (Supp. 2007).

to confuse or mislead. Consumer finance marketing focuses less on the relationship supply to demand than the formation and manipulation of instincts, wants, and urges as reasons borrow.[65] While all financial industry lobbyists are economists at heart, the best advertisers are psychologists.

Consistent with this observation, a growing body of psychological evidence suggests that borrowers have behavioral impulses that lead them into making decisions that are counter to their own best interests.[66] The characterization of financial services markets as driven by rationally comparing the value of one financial service product to others is highly inaccurate. While some borrowers make rational, self-interested, informed decisions on the value of each loan in comparison to its opportunity cost, many do not. At least seven common human psychological patterns create opportunities for predatory lenders to induce contracts that may not be in the best long-term interests of their borrowers.

First, consumers from all walks of life systematically underestimate their exposure to human problems and overestimate their ability to make risk judgments. Because people have difficulty accepting their own vulnerability, most chronically underestimate their chances of heart attacks, asthma, lung cancer, being fired from a job, divorcing within five years after marriage, attempting suicide, and contracting a venereal disease.[67] Workers overestimate their legal protections against employers' arbitrary

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[65] Hooman Estelami, *Cognitive Drivers of Suboptimal Financial Decisions: Implications for Financial Literacy Campaigns*, 13 J. FIN. SERVICES MARKETING 273, 273–283 (2009); Pechmann, et. al., *Navigating the Central Tensions in Research on At'-Risk Consumers: Challenges and Opportunities*, 30 J. PUB. POL'Y & MARKETING 23, 26 (2011).

[66] For articles collecting behavioral research to consumer finance markets *see* Christopher L. Peterson, TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH COST CREDIT MARKET ch. 5 (2004); Oren Bar-Gill, *Seduction by Plastic,* 98 NW. U. L. REV. 1373, 1373-76 (2004); Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725, 725–739 (2005); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price,* 65 MD. L. REV. 707, 707–840 (2006); Estelami, supra note X, at 274; Debra Pogrund Stark and Jessica M. Choplin, *A Cognitive and Social Psychological Analysis of Disclosure Laws and Call for Mortgage Counseling to Prevent Predatory Lending,* 16 PSYCHOLOGY, PUBLIC POLICY AND LAW 85, 85–131 (2010); Karen E. Francis, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry,* 88 TEX. L. REV. 611, 627-631 (2010).

[67] Neil D. Weinstein, *Why It Won't Happen To Me: Perceptions of Risk Factors and Susceptibility*, 39 J of Personality and Soc. Psych. 431 (1980); Neil D. Weinstein and Elizabeth Lachendro, *Egocentrism as a Source of Unrealistic Optimism,* 8 PERSONALITY AND SOCIAL PSYCHOLOGY BULLETIN 195, 195-200 (1982); Neil D. Weinstein, *Unrealistic Optimism about Susceptibility to Health Problems: Conclusions From a Community-Wide Sample*, J. OF BEHAVIORAL MEDICINE 481 (1987); SHELLEY E. TAYLOR, POSITIVE ILLUSIONS: CREATIVE SELF-DECEPTION AND THE HEALTHY MIND (1990); David Dunning et al., *Flawed Self-Assessment: Implications for Health, Education, and the Workplace,* 5 PSYCHOL. SC. PUB. INT. 69, 79-80 (2004).

firings.[68] Even sophisticated managers are prone to treat decisions as unique, generating unreasonably optimistic forecasts by ignoring or minimizing past results.[69] Moreover, even when consumers actually overestimate the probability of emergencies, they typically "think that they personally are peculiarly less susceptible to such events."[70] Consumers tend to be unrealistically optimistic even when negative events have happened to them in the past and when a real, immediate, and visually vivid risk is present.[71]

This natural tendency leaves borrowers systematically vulnerable to exploitative lending. The probability of many of the events that people tend to underestimate, such as sickness, divorce, and job loss, are precisely those events that are the leading causes of insolvency.[72] Moreover, there is robust evidence that borrowers chronically underestimate the cost of credit, even in the face of price disclosures.[73] Credit card borrowers tend to make foolish choices about contractual terms because they are systematically unrealistically optimistic about their future card use and personal circumstances.[74] Federal Reserve Board researchers looking at data for the past 30 years in all demographic groups find credit cardholders' opinions "about their own experiences are almost the reverse of their views about consumers' experiences in general, suggesting considerable concern over the behavior of others and a belief that 'I can handle credit cards, but other

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[68] Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perception of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105 (1997); Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653, 1659 (1998).

[69] Daniel Kahneman & Dan Lovallo, *Timid Choices and Bold Forecasts: A Cognitive Perspective on Risk Taking*, 39 MANAGEMENT SCIENCE 17 (1993); Marta P. Coelho, *Unrealistic Optimism: Still a Neglected Trait*, 25 J. BUS. PSYCHOL. 397 (2010).

[70] Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHICAGO L. REV. 1175, 1184 (1997).

[71] Jerry M. Burger and Michele L. Palmer, *Changes in and Generalization of Unrealistic Optimism Following Experiences with Stressful Events: Reactions to the 1989 California Earthquake*, 18 PERSONALITY AND SOCIAL PSYCHOLOGY BULLETIN 39 (1992); Peter Harris, Wendy Middleton, and Mark Surman, *Give'em Enough Rope: Perceptions of Health and Safety Risks in Bungee Jumping,* 15 JOURNAL OF SOCIAL AND CLINICAL PSYCHOLOGY 9 (1996).

[72] TERESA A. SULLIVAN, ELIZABETH WARREN, AND JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT (2001).

[73] F. Thomas Juster and Robert Shay, *Consumer Sensitivity to Finance Rates: An Empirical and Analytical Investigation,* National Bureau of Economic Research Occasional Paper no. 88, 6–45 (1964); NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES (1972); Jean Kinseyand Ray McAlister, *Consumer Knowledge of the Cost of Open-End Credit*, 15 J. OF CONSUMER RESEARCH 248 (1981); Victor Stango and Jonathan Zinman, *Fuzzy Math, Disclosure Regulation and Credit Market Outcomes: Evidence from Truth in Lending Reform,* 24 REV. OF FIN. STUDIES 506 (2011).

[74] Sha Yang, Livia Markoczy, & Min Qi, *Unrealistic Optimism in Consumer Credit Card Adoption*, 28 J. of Economic Psychology 170 (2007).

people cannot.'"[75] A study relying on point of sale interviews reports that triple- and quadruple-digit interest-rate payday loan borrowers were "hopelessly optimistic in terms of when they expected to be able to repay the loan, particularly at the beginning of the relationship."[76] Many lenders seek to exacerbate this tendency by "shrouding" interest rates—leading borrowers to make life altering decisions with their biased intuitions, rather than careful financial reflection.[77]

Second, many consumers tend to focus on the present benefits of their actions, while underestimating or ignoring longer-term drawbacks. People have an innate difficulty maintaining self-control in the face of immediate gratification. They tend to prefer a benefit that arrives sooner rather than later, in effect "discounting" the value of the later reward.[78] While there are large variations in the rates at which people discount the value of future benefits, decades of empirical research confirm a strong present bias among many consumers.[79] This bias creates difficulty for consumers in attempting to order their financial affairs.[80] The abstract nature of financial pricing makes self-control particularly difficult.[81] For example, saving when an asset is highly liquid is hard.[82] Employees are much more likely to accumulate retirement savings when automatically enrolled in 401(k) savings plans—illustrating the power of suggestion and inertia and the relatively minor role the cognitive process of opportunity cost comparison plays in actual financial decision-making.[83] Rather than carefully weighing the serious long-term consequences of their borrowing, many debtors are irrationally "payment-myopic," focusing on whether they can make bi-weekly or monthly payments instead of whether the contract as a whole is a wise decision. Because the negative aspects of debt occur in the future,

[75] Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970-2000*, 86 FEDERAL RESERVE BULLETIN 623, 628 (2000).

[76] Nathalie Martin, *1000% Interest Rates—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZONA L. REV. 536, 622 (2010).

[77] Stango and Zinman, *supra* note X, at 518.

[78] Richard. H. Thaler, *Some Empirical Evidence on Dynamic Inconsistency*, 8 ECONOMIC LETTERS 201 (1981).

[79] Shane Frederick, George Loewenstein, and Ted O'Donoghue, *Time Discounting and Time Preference: A Critical Review, 40* J. OF ECONOMIC LITERATURE 351 (2002).

[80] Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50 (1991); Philip Bond, David K. Musto, and Bilge Yilmaz, *Predatory Mortgage Lending*, 94 J. OF FIN. ECON. 412 (2009).

[81] Adam Gifford, Jr., *Emotion & Self-Control,* 49 J. OF ECONOMIC BEHAVIOR AND ORGANIZATION 113 (2002).

[82] David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 QUARTERLY JOURNAL OF ECONOMICS 443 (1997).

[83] Brigette C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. OF ECONOMICS 1149 (2001).

these outcomes appear less problematic than they actually will be.[84] Payday and car title loan borrowers face difficult self-control challenge each time a balloon payment comes due. Because renewing loans is so much easier than retiring the entire debt, borrowers must overcome the temptation to renew their loan each in order to step off the debt treadmill. [85]

Third, consumer lending markets are likely to be distorted by distressed abbreviated reasoning patterns. Psychologists report consumers who are suffering from emotional distress, embarrassment, desperation, or fear frequently make poor decisions regarding values and risk.[86] People's impulse control breaks down when they face emotional distress.[87] Most people have limited attention capacity. When they use this attention to cope with a stressor, many consumers use truncated reasoning to quickly escape the stressful situation by seizing on the first minimally-acceptable option available to them.[88] Because many consumers are in the market to borrow money precisely to deal with some financial threat, they are likely to lack the attention required to resist the temptation of a temporary financial "quick-fix." Moreover, the most vulnerable loan applicants tend to have problematic credit histories, which lead them to evaluate loan pricing while fearing the embarrassment and rejection. These conditions are likely to inhibit loan applicants' ability to adjust their perceptions of price as they learn about loan terms.[89]

Fourth, even those borrowers who are not shopping for credit under distress have great difficulty understanding and comparing credit prices. Research shows that consumers tend to reduce the amount of effort they expend on making sound decisions when those decisions become more complex—a phenomenon known as information overload.[90] When faced

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[84] Gretchen B. Chapman, *Temporal Discounting and Utility for Health and Money*, 22 EXPERIMENTAL PSYCHOLOGY: LEARNING, MEMORY, AND COGNITION 771 (1996).

[85] Francis, *supra* note X, at 628.

[86] Karen Pezza Leith & Roy F. Baumeister, *Why Do Bad Moods Increase Self-Defeating Behavior? Emotion, Risk Taking, and Self-Regulation*, 71 J of Personality and Social Psychology 1250 (1996); Roy F. Baumeister, *Esteem Threat, Self-Regulatory Breakdown, and Emotional Distress as Factors in Self-Defeating Behavior*. 1 REVIEW OF GENERAL PSYCHOLOGY 145 (1997).

[87] Diane M. Tice, Ellen Bratslavsky, & Roy F. Baumeister, *Emotional Distress Regulation Takes Precedence Over Impulse Control: If you Feel Bad, Do It!*, 80 J. OF PERSONALITY AND SOCIAL PSYCHOLOGY 53 (2001).

[88] Giora Keinan, *Decision Making Under Stress: Scanning of Alternatives Under Controllable and Uncontrollable Threats*, 52 J. OF PERSONALITY AND SOCIAL PSYCHOLOGY 639 (1987); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: the Problem of Predatory Lending: Price*, 65 MARYLAND L. REV. 707 (2006).

[89] Karim S. Kassam, Katrina Koslov, & Wendy Berry Mendes, *Decisions Under Distress: Stress Profiles Influence Anchoring and Adjustment*, 20 PSYCHOLOGICAL SCIENCE 1394 (2009).

[90] John W. Payne and James R. Bettman, *When Time is Money: Decision Behavior Under Opportunity-Cost Time Pressure*, 66 ORGANIZATIONAL BEHAVIOR AND HUMAN

with complex credit price disclosures and boilerplate contracts, borrowers tend to focus on only a few salient aspects of the decision, or even fail to try to understand the information at all.[91] Moreover, when borrowers lack experience or understanding of financial and legal terms of loan contracts, the opportunity cost of comparing shopping from multiple creditors can be quite high, suggesting that careful comparison may not even be rational for borrowers who have literacy and numeracy challenges.[92] The U.S. Department of Education's most recent national survey of adult literacy finds that 22 percent of American adults lack even the most basic quantitative literacy skills.[93] These citizens have difficulty performing basic quantitative tasks such as using or understanding numbers included in print materials. Thus, they are systematically vulnerable to deceptive and misleading credit pricing tactics.[94] Indeed, at least one analysis of the subprime mortgage crisis reports a strong correlation between numerical ability and foreclosure.[95]

Fifth, the language, terminology, and marketing practices used to present credit contracts can strongly influence how borrowers perceive prices. Compelling evidence suggests that the way pricing and risk information is presented, or "framed," can consistently influence human choices.[96] For example, people are more averse to medical treatments when identical risk data are framed as a mortality rate than when framed as a survival rate.[97] Consumers treat identical investment risks differently

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DECISION PROCESSES 131 (1996); Julie R. Agnew & Lisa R. Szykman, *Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience*, 6 J. OF BEHAVIORAL FINANCE 57 (2005).

[91] Jeffrey Davis, *Protection Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Codification of Consumer Credit Contracts*, 63 VA. L. REV. 841 (1977).

[92] PETERSON, TAMING THE SHARKS, *supra* note X, at 131 ("The costs of acquiring information must be evaluated relative to the resources of credit shoppers.").

[93] UNITED STATES DEPARTMENT OF EDUCATION, NATIONAL ASSESSMENT OF ADULT LITERACY (2003).

[94] Alan M. White, Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233 260-62 (2002); Gerard Caprio, Jr., *The Great Innumeracy Epidemic*, 11 FINANCIAL REGULATOR 37, 37 (2007).

[95] Kristopher Gerardi, Lorenz Goette, and Stephan Meier, *Financial Literacy and Subprime Mortgage Delinquency: Evidence from a Survey Matched to Administrative Data*, Working Paper, Federal Reserve Bank of Atlanta Working Paper Series. (2010).

[96] Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCIENCE 453 (1981).

[97] Barbara J. McNiel, Stephen G. Pauker, Harold C. Sox, and Amos Tversky, *On the Elicitation of Preferences for Alternative Therapies*, 306 NEW ENGLAND JOURNAL OF MEDICINE 1259 (1982); Tversky, Amos, and Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. OF BUSINESS S251–S278 (1986).

depending on whether they are presented as a gamble or insurance.[98] These patterns exist and can be manipulated in consumer financial services markets. For example, "[i]ndividuals will perceive a penalty for using credit cards as a loss and a bonus for using cash as a gain; this although the two situations are, from an economic and end-state perspective, identical."[99] Payday lenders prefer to describe their loan prices as a percentage of the loan principal, rather than with a simple nominal annual interest rate because, for example, borrowers are likely to perceive a two week loan with a price of 15 percent of the amount financed as less expensive than a the same loan with a 391 percent simple nominal annual interest rate—even though these prices are in fact identical.[100]

Moreover, people tend to rely too heavily on first impressions when assessing risk and value.[101] This is to say, people tend to "anchor" on early estimates and fail to sufficiently revise their perception of price or risk when further information comes to light.[102] For example, research suggests anchoring on the early estimate of the value of a lawsuit tends to disrupt later settlement negotiation.[103] Even accountants conducting audits anchor on early estimates and insufficiently correct their judgments.[104] Marketing professionals have absorbed these lessons and systematically design sales tactics to exploit this pattern in judgment making.[105]

Sixth, an impressive body of empirical research indicates most people are irrationally averse to losses. The classical economic account of rational decision making suggests individuals should value their out of pocket costs

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[98] Hershey, John C., and Paul J. H. Schoemaker, *Risk Taking and Problem Context in the Domain of Losses: An Expected Utility Analysis*, 47 JOURNAL OF RISK AND INSURANCE 111 (1980).

[99] McCaffery, Edward J., Daniel J. Kahneman, and Mathew L. Spitzer, *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards, in* BEHAVIORAL LAW AND ECONOMICS 259, 262 (Cass R. Sunstein, ed., 2000).

[100] Peterson, *Salience Distortion*, *supra* note X, at 1194.

[101] Mathew Rabin and Joel L. Schrag, *First Impressions Matter: A Model of Confirmatory Bias*, 114 QUARTERLY JOURNAL OF ECONOMICS 37 (1999).

[102] Amos Tversky and Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124 (1974); Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCHOLOGICAL BULLETIN 197 (1981); Einhorn, Hillel J., and Robin M. Hogarth, *Decision Making Under Ambiguity, in* RATIONAL CHOICE: THE CONTRAST BETWEEN ECONOMICS AND PSYCHOLOGY 41 (Robin M. Hogarth and Melvin W. Reder, eds., 1987); Richard H. Thaler, *The Psychology of Choice and the Assumption of Economics, in* QUASI RATIONAL ECONOMICS 137–167 (Richard Thaler ed., 1994).

[103] Daniel Kahneman, and Amos Tversky. *Conflict Resolution: A Cognitive Perspective, in* BARRIERS TO CONFLICT RESOLUTION 44–62 (Kenneth J. Arrow, et al., eds., 1995).

[104] William R. Kinney Jr., and Wilfred C. Uecker, *Mitigating the Consequences of Anchoring in Auditor Judgments*, 57 ACCOUNTING REVIEW 55–69 (1982).

[105] Brian Wansink, Robert J. Kent, and Stephen J. Hoch. *An Anchoring and Adjustment Model of Purchase Quantity Decisions*, 35 JOURNAL OF MARKETING RESEARCH 71 (1998); Estelami, *supra* note X, at 279; Stark and Choplin, *supra* note X, at 23–25.

in the same manner as they value forgone opportunities. This is to say, people should not be more displeased with losses than they are pleased with equivalent gains. But, some data indicate consumers are actually roughly twice as displeased with loses as they are pleased with equivalent gains. A related tendency makes consumers willing to assume an objectively inordinate amount of risk when facing the loss of something they already possess. For example, people who have owned antique furniture or vintage wine for a long period of time commonly refuse to sell their possessions for prices far greater than market value—even though they could buy a replacement and pocket the difference. Some economists explain this is because the owners have "endowed" their possessions with personal value.[106] Similarly, many firms sell products with "a thirty day trial offer" with a "no questions money back guarantee," where the consumer does not have to pay until after the temporary period expires. The seller realizes the buyer will pay a higher price after endowing the product with personal value, or stated differently, the buyer will pay more to avoid losing a product they already have. By holding on too tightly to the things they possess, many consumers exhibit a classically irrational bias for preserving the status quo.[107] In the high cost credit market, lenders have learned to exploit loss aversion. For example, car title lenders, also called "auto pawn" companies, often extract more payment out of consumers who do not want to lose their cars than the cars themselves are worth.[108] Similarly, homeowners that have fallen behind on mortgage payments will often agree to onerous terms refinancing their homes in order to avoid foreclosure.

Finally seventh, credit contracts generally, and high-interest consumer financial products in particular, have the potential to exacerbate the harm of addictive and compulsive consumer behavior. A reality in modern life is that many Americans suffer from addictions and compulsive behavior. The problems of alcoholism, pathological gambling, and compulsive shopping all have the potential to be negatively interrelated with consumer credit.[109] Addicted and compulsive consumers can use exhaustion of their financial

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[106] Daniel Kahneman, Jack L. Knetsch, and Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*. 98 J. OF POLITICAL ECONOMY 1325 (1990); Cynthia E. Devers, Robert M. Wiseman, and R. Michael Holmes, *The Effects of Endowment and Loss Aversion in Managerial Stock Option Valuation*, 50 ACADEMY OF MANAGEMENT JOURNAL 191(2007).

[107] Daniel Kahneman, Jack L. Knetsch, and Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 JOURNAL OF ECONOMIC PERSPECTIVES 193(1991).

[108] PETERSON, TAMING THE SHARKS, *supra* note X, at 175.

[109] Ronald J. Faber U Thomas C. O'Guinn, *Compulsive Consumption and Credit Abuse*, 11 J. of Consumer Policy 97 (1988); Henry R. Lesieur, *Compulsive Gambling*, Society 43 (May/June 1992); Howard Tokunaga, *The Use and Abuse of Consumer Credit: Applications of Psychological Theory and Research*, 14 J. OF ECONOMIC PSYCHOLOGY 285 (1993).

resources as a self-control mechanism—terminating a gambling binge, for example, once the consumer has no more money left.[110] Consumer credit, particularly when offered on predatory terms can create the constant possibility of relapse. Market forces do not protect this large and vulnerable segment of the population from onerous debt problems.

Collectively, these behavioral patterns suggest a very different picture of the free market than the portrait painted by advocates of weak law. Marketing academics have long recognized that aggressive advertisers can leverage these heterogeneously distributed behavioral patterns by targeting inefficient consumers.[111] Unlike the homogeneous pricing of most goods, consumer loans are underwritten to the needs and abilities of individual borrowers, giving lenders the opportunity to heterogeneously price loans based on the inabilities and misunderstanding of loan applicants. In many markets, shoppers discipline pricing and quality. But in consumer finance markets, lenders can segment the market based on consumer vulnerability, rather than on product quality.[112]

In addition to behavioral research, some scholars have attempted to explore the welfare effects of high cost, small consumer loans. However, this research is notoriously difficult for a variety of reasons. Borrowers are often embarrassed and confused regarding their financial circumstances and are reluctant or unable to self report their difficulties. This borrower population is also likely to be more mobile than many populations, changing jobs, addresses, and telephone numbers more frequently than more affluent families introducing difficulties in tracking borrowers over longer durations. Payday and car title lenders have not historically reported their repayment patterns with the national credit bureaus and many borrowers in this market are not plugged in to the mainstream economy in the same way as more affluent people. It is challenging to separate out the effects of other financial stressors and demographic forces in borrowers' lives. Many studies have been unable to account for local, regional, and

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[110] Florida Council on Compulsive Gambling, *Gambling on Credit: Exploring the Link Between Compulsive Gambling and Access to Credit* 19 (May 2006), a*vailable at:* http://gamblinghelp.org/media/.download_gallery/Gambling%20on%20Credit.pdf (finding that "easy access to credit accelerates the problem and process of a gambling addiction, increasing the likelihood that compulsive gamblers will gamble more often, incurring higher levels of debt, and ultimately inviting more severe personal and financial consequences when their resources are exhausted.").

[111] Terri L. Riggenburg and Madhavan Parthasarathy, *Ethical Implications of Target Market Selection*, 17 J. of Macromarketing 49 (1997) ("One implication may be another form of market ***segmentation***, or an additional dimension for identifying subsegments: taking product category and vulnerability of consumers into consideration. This method may be useful in marketing, not only socially desirable products, but also potentially harmful products.").

[112] Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 Minn. L. Rev. 749, 767 n.78 (2008); Kathleen C. Engel and Patricia A. McCoy, Subprime Virus: Reckless Credit, Regulatory Failure, and Next Steps (2011).

national changes in labor markets; the effects of the housing bubble and crisis over the past fifteen years; and the complex dynamics of other social forces that effect low and moderate income communities such as crime, drug addiction, divorce rates, the number of dependents per wage earner, educational levels, educational quality, military service, and racial discrimination. Many families are profoundly affected by the fluctuating cost of gasoline, the rising price of health care, declining access to health insurance, all of which exist across complex temporal, spatial, legal, and social patterns. Studies of payday and car title lending must also contend with causal noise created by other forms of credit, asset accumulation, and asset protection including credit cards, bounce protection plans, pawnshops, installment loans, negotiating delayed payments with creditors, credit union programs, peer-to-peer online lending, family support networks, and saving accounts, and the ability of borrowers to evading creditor collection remedies. Many studies make no effort to account for how the differences in unsecured creditor remedies in various legal jurisdictions. The growing use of payday loans legally and illegally offered over the Internet also clouds studies on the effect of laws regulating small loan markets. Even in states where the state government is attempting to collect useful data, many members of the small loan industry actively evade these reporting requirements as well as the consumer protection laws that generally go along with them. The civil justice system does not generally provide useful information about this market because the size of loans often makes litigation cost-prohibitive from borrowers' perspectives. Many payday and car title lenders have arbitration agreements that force borrowers into secret private dispute resolution. And most of all, the people who could supply the information to overcome these hurdles--payday and car title lenders themselves--generally refuse to release their loan data.

Nevertheless in recent years researchers have released a growing number of papers, some of which have been published, that purport to show both beneficial and harmful effects of payday lending.[113] While a complete

[113] This research includes: Sumit Agarwal, Paige Marta Skiba & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Scoring Puzzles*, Working Paper (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1327125; Dennis Campbell, F. Asis Martinez Jerez & Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Account Closures*, (Harvard Business School Working Paper December, 2008); Scott E. Carrell & Jonathan Zinman, *In Harm's Way? Payday Loan Access and Military Personnel Performance* (FRB of Philadelphia Working Paper No. 08-18, August 1, 2008); Susan P. Carter, Paige M. Skiba & Jeremy Tobacman, *Pecuniary Mistakes? Payday Borrowing by Credit Union Members*, (Working Paper 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1707657; Adair Morse, *Payday Lenders: Heroes or Villains*, 102 J. FIN. ECON. 28, 30 (2011); Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy*, (Working paper 2009), *available at:* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215; Donald P. Morgan & Michael

exposition of this growing body of literature is beyond the scope of this Article, a few illustrative examples are helpful. For instance, the payday lending industry has widely distributed an unpublished working paper written by Donald Morgan and Michael Strain.[114] Morgan and Strain concluded that the re-imposition of traditional interest rate limits in North Carolina and Georgia led to: greater rates of bounced checks than the national average; more complaints to the Federal Trade commission about lenders and debt collectors; and, Chapter 7 bankruptcy filing at rates greater than the national average.[115] However, consumer advocates at the Center for Responsible Lending aggressively challenged the study's methods.[116] With respect to the bounced check claim, Morgan and Strain used regional data from the Federal Reserve's regional check processing centers (CPCs) as proxies for North Carolina's and Georgia's bounced check rates.[117] But, these regional returned check rates indistinguishably mixed in returned checks from Alabama, Louisiana, southern Mississippi, South Carolina, and Tennessee—all of whom had legal and rapidly growing payday lending industries during the study period.[118] Moreover, the study did not control for a host of other independent regionally related factors that could have accounted for a very small reported increase in bounced checks across the region including, for example, hurricane Katrina.[119] With respect to FTC complaints, the Center for Responsible Lending pointed out that the study did not account for the generally rising FTC complaint rates prior to the study period, nor the fact that complaint rates are likely driven by the growing unrelated problem of identity theft. [120]Even more problematic was the studies useless bankruptcy data which did not control for other

R. Strain, *Payday Holiday: How Households Fare After Payday Credit Bans,* (Working Paper 2007), *available at:* http://www.newyorkfed.org/research/economists/morgan/papers.html.; Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEVELOPMENT. Q. 8 (2003); Petru S. Stoianovici & Michael T. Maloney, *Restrictions on Credit: A Public Policy Analysis of Payday Lending* (October 2008), *available at:* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1291278; Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap*, 34 J. Banking & Fin. 546 (2010).

[114] Donald P. Morgan & Michael R. Strain, *Payday Holiday: Households Fare after Payday Credit Bans*, Federal Reserve Bank of New York Staff Report no. 309 (November 2007, Revised February 2008).

[115] *Id.* at 26.

[116] Center for Responsible Lending, *CRL Critique of "Payday Holiday: How Households Fare After Payday Credit Bans"by Donald P. Morgan and Michael R. Strain*, January 2008, *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/states/crl-morgan-critique-12-10.pdf.

[117] Morgan & Strain, *supra* note X, at 3.

[118] Center for Responsible Lending, *Critique of "Payday Holiday," supra* note X, at 4.

[119] *Id.*

[120] Id.

independent variables that "greatly influence a person's chances of filing for bankruptcy protection, including health insurance coverage, foreclosures, divorce rates, [and] demographic factors such as income."[121] Despite all these limitations (as well as the author's disclaimer that its findings were "preliminary" and shared "solely to stimulate discussion"),[122] the Morgan and Strain paper remains notable because industry lobbyists have so frequently supplied the piece to state legislatures and quoted it in the press that it remains the most prominently discussed proxy welfare variable study to date.

In contrast, Brian Melzer's more recent study published in the *Quarterly Journal of Economics* measures the effects of payday loan availability on borrower well being.[123] Using a clever study design Meltzer focused on families from states that effectively banned payday lending, but nonetheless had access to payday loans because they lived just over the border of a state that allowed payday lending.[124] This allowed Melzer to compare families that had cross-border access to payday loans with similar families that did not have access to payday loans.[125] Melzer measured borrower well being with self-reported variables including: postponed medical care, postponed dental care, postponed prescription drug purchases; difficulty paying mortgage, rent or utility bills; moving out of one's home due to financial difficult; skipping meals; and, going without telephone service.[126] Melzer conducted a variety of different regressions to discover whether access to payday loans caused an increase in hardship. In addition to baseline regressions, also did regressions one focusing on differences in payday loan access over time and another measuring focusing on different income groups, both of which confirmed his baseline results.[127] Melzer found compelling evidence that families with access to payday loans were more likely to have difficulty paying their bills, to skip meals, and live without access to a telephone. His results suggest, for example, that the likelihood of reporting difficulty paying bills increases by 25% for families

[121] *Id.*
[122] Morgan & Strain, *supra* note X, at cover page.
[123] Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q. J. of Econ. 517 (2011).
[124] *Id.* at 518-19.
[125] *Id.*
[126] *Id.* at 525-26.
[127] *Id.* at 537-47. In addition to his regressions, Meltzer also conducted two falsification exercises to test whether his results held true in income groups that do not commonly use payday loans. Melzer's falsification tests found that geographic access to payday loans had no effect on individuals who do not use payday loans because they either had such minimal income they cannot qualify for payday loans or because their income is so high they have access to cheaper forms of credit. *Id.* at 534-37. These tests further strengthen Meltzer's case that his regressions capture a causal effect of payday loan access.

with access to payday loans.[128] Melzer also found that families with access to payday loans were more likely to suffer health related hardship by postponing medical and dental care, as well as forgoing prescription drug purchases.[129]

Similarly, Kurbin, Squires, and Graves recently published a study in the *Journal of Criminology and Public Policy* that found evidence showing the density of payday lending locations causes an increase in local crime rates.[130] They mapped payday lender locations and compared these locations to reported violent and property crime rates in census tracts within the Seattle area regressing for a broad array of independent variables that included: percent secondary low-wage jobs, the jobless rate, the percent of employed people working as professionals or managers, the percent of high-school graduates, the poverty rate, the percent of Black people, the percent of young males, a residential instability index, the percent of female headed households, and population—all of which have been shown to be related to community crime rates.[131] This study attempted to account for multicoliniarity between the independent variables, spatial auto correlation, and endogeneity between crime and payday lender density. In three different regression models the study found that "payday lending is significantly associated with both violent and property crime rates. This relationship holds even after controlling for a host of factors typically associated with neighborhood crime rates."[132] The study asserted that "payday lending imposes broader community costs" that "*all* residents pay when they reside in neighborhoods with a concentration of payday lenders."[133] Taking one specific example of just such a community cost, the study points out that much research has shown a strong relationship between crime rates and property value,[134] which suggests that payday lending locations may depress property values.[135] This claim will not surprise many local government leaders around the country who have frequently asserted the same point.[136]

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[128] *Id.* at 534.

[129] *Id.* at 550.

[130] Charis E. Kubrin, Gregory D. Squires, Steven M. Graves, Graham C. Ousey, *Does Fringe Banking Exacerbate Neighborhood Crime Rates? Investigating the Social Ecology of Payday Lending*, 10 CRIMINOLOGY & PUBLIC POLICY 437 (2011)

[131] *Id.* at 444-46.

[132] *Id.* at 456.

[133] *Id.* at 457.

[134] David R. Bowes and Keith R. Ihlanfeldt, *Identifying the Effects of Rail Transit Stations on Residential Property Values*, 50 J. URBAN ECON. 1 (2001); Steve Gibbons, *The Costs of Urban Property Crime*, 114 THE ECONOMIC JOURNAL F441(2004); Richard H. Thaler, *A Note on the Value of Crime Control: Evidence from the Property Market,* 5 J. URBAN ECON. 137 (1978).

[135] Kurbin, et al., *supra* note X, at 458.

[136] *See, e.g.,* Editorial, *Some Firms Hurt Neighborhoods*, OMAHA WORLD-HERALD, February 4, 2009 ("Asked why neighborhood associations don't support whatever businesses

While the social science is by no means unanimous, the best evidence suggests that small high cost loans are harmful to borrowers and their communities on balance.[137] Given the complexity of the research, local government leaders can be excused for trusting their instincts, their values, and their own common sense. We have a long legacy of many of our most respected leaders and profound thinkers rejecting the notion that consumer lending markets are naturally efficient. For example, while the early American founding fathers were passionately committed to the value of freedom, they had virtually no confidence in the inherent efficiency of financial markets. President George Washington, the father of our country, explained, "there is no practice more dangerous than borrowing money . . . for when money can be had in this way, repayment is seldom thought of in time . . . Exertions to raise it by dint of industry ceases. It comes easy and is spent freely and many things indulged in that would never be thought of, if to be purchased by the sweat of the brow. In the mean time, the debt is accumulating like a snowball in rolling."[138] Thomas Jefferson, author of the declaration of independence, famously feared banks more than standing armies.[139] And, Benjamin Franklin, the principal advocate of the bill of rights wrote:

> [T]hink what you do when, *you run* in debt you give to another power over your liberty. . . . . When you have got your bargain, you may, perhaps, think little of payment; but

choose to locate within their borders or on their periphery, our answer is quite simple. When zoning laws enable predatory businesses to fill in the empty storefronts of our neighborhoods, we see increased crime, decreased property values and neighbors afraid to walk outside their doors after dark. Predatory businesses : like payday loan operations . . . prey on those whose ties to society already are weakened."); Annysa Johnson, *Payday Loan Stores in Crosshairs: Tosa imposes one-year Moratorium While it Studies Permanent Restrictions*, MILWAUKEE J. SENTINEL, September 21, 2006 ("Wauwatosa's moratorium is in response to neighbors' complaints that the . . . [payday loan] store would attract crime and lower property values.");

[137] *See Regulatory Restructuring and Reform of the Financial System, Hearing Before the U.S. House of Representatives Committee on Financial Services*, 110th Cong., 2nd Sess., October 21, 2008 (prepared statement of Joseph E. Stiglitz) (Nobel Prize winning economist arguing "Exploitive practices of the financial sector need to be curbed. The financial sector realized that there was money at the bottom of the pyramid, and they moved with all speed to ensure that it moved to the top. The exploitive practices include pay-day loans, predatory lending, and rent-a-furniture and similar scams. There needs to be a usury law (and this also applies to credit cards) limiting the effective rate of interest paid by users of the financial facility.").

[138] RON CHERNOW, WASHINGTON: A LIFE 108 (2010).

[139] Letter from Thomas Jefferson to John Taylor, (May 28, 1816), *in* THE WORKS OF THOMAS JEFFERSON IN TWELVE VOLUMES, FEDERAL EDITION (Paul Leicester Ford, ed., 1905) *available at* http://memory.loc.gov/cgi-bin/query/r?ammem/mtj:@field(DOCID+@lit(tj110172 ("And I sincerely believe, with you, that banking establishments are more dangerous than standing armies. . . .").

> *creditors*, . . . *have better memories than debtors.* . . . The day comes round before you are aware, and the demand is made before you are prepared to satisfy it, or if you bear your debt in mind, the term which at first seemed so long will, as it lessens, appear extremely short. Time will see, to have added wings to his heels as well as shoulders. . . . *The borrower is a slave to the lender, and the debtor to the creditor*, disdain the chain, preserve your freedom; and maintain your independency: be industrious and free; be frugal and free.[140]

The United States of America was founded on the shoulders of leaders that refused to tolerate abusive loans.

Indeed, Adam Smith himself, lacked confidence in the efficiency of consumer finance markets. Instead of relying on his own insights into naturally efficient markets, Smith emphasized the importance of overconfidence bias in financial decision-making stating that, "[t]he overweening conceit which the greater part of men have of their abilities is an ancient evil remarked by the philosophers and moralists of all ages … The chance of gain is by every man more or less over-valued and the chance of loss by most men undervalued . . ."[141] Indeed, in his great treatise, *the Wealth of Nations*, Adam Smith argued that behavioral patterns such as overconfidence bias and hyperbolic discounting made usury limits indispensible. In his words, high interest rate limits allow money to be lent to "prodigals and projectors" that are "likely to waste and destroy" capital overall.[142] Instead Smith argued that usury limits should be set "somewhat above … the lowest market rate."[143] With respect to high cost loans, the inventor of the invisible hand did not believe in the invisible hand.

III. ZONING IN THE VOID: THE LOCAL RESPONSE TO PREDATORY SMALL LOANS

Like Adam Smith, many local government leaders believe should usury laws to limit prices in the market for small consumer loans. To this effect many local governments feel compelled to fill the void in leadership on predatory lending in the absence of effective state and federal action. Moreover, because public opinion favoring limits on small loan pricing has proven more durable than the limits themselves, local leaders face significant constituent pressure to respond to payday and car title lending. In the past few years, at least one hundred and thirty five local governments have attempted to restrict, regulate, or otherwise arrest the development of

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[140] Benjamin Franklin, *The Way to Wealth*, 1 THE NORTON ANTHOLOGY OF AMERICAN LITERATURE 213, 217–18 (Nina Baym, et. al., eds., Shorter Fourth ed. 1990).

[141] ADAM SMITH, WEALTH OF NATIONS 164 (1776).

[142] *Id.* at 147.

[143] *Id.* at 147.

usurious lending within their boundaries.[144] Local governments with starkly different political and demographic profiles have reached similar conclusions regarding the need to inhibit predatory small loans within their neighborhoods. For example, San Francisco, one of the nation's most liberal cities, has adopted a fringe lending ordinance very similar in approach to those found in small, conservative towns like Little Elm, Texas, and American Fork, Utah.[145] Even still, this significant groundswell of local support for restrictions on predatory small loans likely understates the actual support for regulation because the limits on local government power probably deters some governments from acting.[146]

Local leaders hoping to inhibit predatory lending within their communities must contend with federal and state preemption of their ordinances. Federal preemption controls local ordinances just as it does state legislatures.[147] So, for instance, local governments lack the power to cap interest rates charged by banks and credit unions under the Supreme Court's *Marquette* doctrine and its related legislative buttressing.[148] Moreover, statutes adopted by state legislatures can, in some contexts, also preempt local ordinances. [149]

Nevertheless, local governments do retain some powers traditionally reserved for local governments. Some local leaders have aggressively pushed the outer boundaries of these powers by attempted to altogether eliminate predatory small loans within their cities or counties. For example, Jacksonville, Florida adopted an ordinance attempting to cap payday loan prices. Florida state law generally imposes a usury limit of 18%.[150] Lenders exceeding this price cap without a license are subject to criminal

[144] Griffith, Hilton, & Drysdale, *supra* note X, at 15–20.

[145] Griffith, Hilton, & Drysdale, *supra* note X, at , 16, 18, 19; Pallavi Gogoi, *Costly Cash: In Texas, Towns Try Zoning out Payday Lenders*, DAILY FINANCE, March 10, 2010; *New Rules for Payday Lenders*, ABC7 KGO-TV SAN FRANCISCO, December 26, 2007.

[146] *See, e.g., Dallas Council Urged to Limit Payday Lending Sites*, Dallas Morning News, January 4, 2011 ("Council member Tennell Atkins, who's far southern Dallas district is home to dozens of payday-lending stores, said he's '125 percent against them.' But a resolution to the Legislature may be an empty gesture, he said. The industry's powerful lobbying arm has spread hundreds of thousands of dollars to elected officials in Austin, he said.").

[147] U.S. CONST art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

[148] *See infra* notes X through X, and accompanying text.

[149] *See infra* Part IV.A. for a discussion of the law of state preemption of local ordinances.

[150] *See* FLA. STAT. ANN. §§ 687.02(1), 687.03(1).

prosecution.[151] But, the Florida legislature has also granted licenses to payday lenders allowing them to charge fees amounting to an interest rate of around 300% on a typical payday loan.[152] Many Florida payday lenders ignore this high limit by purporting to partner with a broker, called a credit service organization, that charges a fee for arranging the payday loan.[153] In effect, many payday lenders entirely ignore Florida's triple digit interest rate price cap through this loophole.

Resentful of the consequences of these loans for its citizens, particularly the many military service members stationed at a local navy base, Jacksonville attempted to push for a more consumer friendly usury law by adopting its own 36% interest rate limit.[154] The city took the position that the state's price cap on payday lending constituted a consumer protection floor that the city could raise if it chose to do so.[155] Nothing in the state's payday lending statute explicitly contradicted this interpretation. Nevertheless, when a payday lender challenged the city's ordinance, a state trial judge struck down the price cap holding that the state legislature had intended to preempt local price regulation.[156]

Less direct than Jacksonville, St. Ann, Missouri, a small suburb of St. Louis, attempted to prevent triple digit payday lending within its city by framing it's prohibition as an exercise of municipalities' traditional right to use zoning law for land use planning.[157] The Missouri legislature has adopted a statute that authorizes licensed payday lenders to collect interest and fees up to 75% of the initial principle of any single loan.[158] While there is some ambiguity in the statute, the law's most simple interpretation appears to authorize accrued interest of 75% of the loan principle which in typical two week payday loan of $325 constitutes an astounding annual interest rate of 1955.36%.[159] Concerned about the stability and propriety of this type of lending, St. Ann acted to protect its citizens with an ordinance that read:

> A business engaged in providing short- term loans to members of the public as a primary or substantial element of its operations and which is not licensed by the appropriate state or federal agency as a

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[151] Unlicensed lending at annual interest rates of above 25% is a crime in the state of Florida. Fla. Stat. Ann. § 687.071 (2011).

[152] *Id.* § 560.404(6).

[153] Peterson, *Salience Distortion*, *supra* note X, at 1152.

[154] Advance America, Cash Advance Centers of Florida, Inc. v. The Consolidated City of Jacksonville, Florida, Fourth Judicial Circuit Court, Duval County, Case No.: 16-2005-CA-7025-XXXX-MA, Division CV-D (June 1, 2006).

[155] *Id.*

[156] *Id.*

[157] Grifith, Hilton, and Drysdale, *supra* note X, at 26.

[158] MO. REV. STAT. §§ 408.100, 408.505(3) (Supp. 2011).

[159] Peterson, *Salience Distortion*, *supra* note X, at 1139.

> bank or savings and loan association. Such business is prohibited in all zoning districts of the City of St. Ann. [160]

While the ordinance did not presume to cap interest rates—something that would have clearly contradicted Missouri's extremely high price limit on payday loans—it did refuse to grant a local business license to any non-depository short term lender.[161] A payday lender brought suit challenging the ordinance and the case eventually made its way to the Missouri Supreme Court. The Court held that although the ordinance purported to be a zoning measure, state law nonetheless preempted it because St. Ann had prohibited an activity that state law permits.[162]

So limited, some local governments have attempted to use the persuasive power of their moral authority, rather than the operation of law to prevent predatory small loans. For example, some cities and counties have adopted non-binding resolutions demanding that their state legislature re-establish traditional usury limits.[163] Local governments in Virginia, where legislative battles on payday and car title lending have become a seasonal fixture, have pursued this strategy in particular. Over 30 different local governments have adopted non-binding resolutions demanding that Virginia's reestablish a traditional usury limit of 36%.[164] But, as this article goes to press, a majority of the Virginia Assembly has remained unpersuaded.

While Jacksonville and St. Ann serve as examples of ordinances that did not survive judicial challenge, there are many more local governments that have taken measures that do remain in force. In recent years, local governments have turned to their well accepted power to adopt zoning ordinances to stem the tide of payday and car title lending within their jurisdictions. These zoning ordinances tend to take one or more of three basic forms: (1) restrictions on the location where predatory lenders can operate; (2) discretional permits that restrict who may obtain licenses to engage in predatory lending; and (3) permanent or temporary limits on the number of predatory lending locations within a jurisdiction.

First, perhaps the most common local restriction on predatory lending outlets is limits on where lenders can locate. Some jurisdictions restrict the

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[160] State ex rel. Sunshine Enterprises of Missouri, Inc. v. Board of Adjustment of City of St. Ann, 64 S.W.3d 310, 312 (Mo. 2002) (quoting St. Ann, Missouri, Ordinance 2074).

[161] *Id.*

[162] *Id.* at 314

[163] Resolution No. 3202, § 1, Sachse, Texas (April 5, 2010) ("[T]he City of Sachse urges the Texas State Legislature and the Governor of Texas … to enact laws that will … [c]lose the **loophole** in state law that allows payday, auto title, and other consumer loans to carry annual percentage rates upwards of 500%.") (emphasis in original).

[164] Anita Kumar, *Pressure Mounts on Va. Payday Lenders: Coalition Plans to Push Legislature for Limits*, December 3, 2007, B01; Griffith, Hilton, & Drysdale, *supra* note X, at 20.

proximity of predatory lenders to residences, churches, schools, or other protected buildings. For example, Jacksonville, Florida now prohibits the location of payday lenders within five miles of an active military installation.[165] Some local governments also restrict predatory lenders from clustering together by requiring a minimum distance separating locations.[166] There is considerable variety in the required minimum distance, with some leaders adopting a cosmetic six hundred feet and others requiring as much as a mile of separation.[167] Other local leaders have protected specially zoned commercial districts or streets where predatory lenders are not allowed. For example, Sachse, Texas prohibits payday lenders, check cashers, and car title lenders from locating within 500 feet of the President George Bush Tollway.[168]

Second, many local governments have adopted ordinances that require a special permit prior to opening a predatory lending location. These conditional permits typically require an application and a public hearing in front of some type of land use planning board. These hearings give an opportunity to look into the background of the permit applicant and consider the merits of the proposed location. While there is variation in local practices, the ordinances which create these conditional permit requirements tend not to impose overly restrictive standards on who can receive a permit. In practice, these permit requirements create a small barrier to entry, but typically do not empower planning boards to effectively eliminate predatory small loan outlets in their community.

Third, some jurisdictions have explicitly limited the number of predatory small loan locations that may exist within their community. For example, the leaders of St. Ann, Texas, who unsuccessfully attempted to prohibit all payday lenders in their town, have since limited payday lenders to no more than three locations. Some cities and counties have adopted limits relative to the population. For example, West Valley City, Utah has an ordinance limiting payday lenders to no more than one store per ten thousand residents.[169] Still, other governments have adopted temporary

[165] Jacksonville, FL Zoning Code §656.401(ii)(1)(a).

[166] *See, e.g.*, Ordinance No. 1397.17.35, § 17.12.415(1), Casa Grande, Arizona, January 3, 2009 (requiring a minimum distance of 1320 feet separating deferred presentment companies).

[167] *Compare* West Valley City Code, § 7-1-103 (30) *with* Sandy City Code, § 15A-11-20(A)(1) (stating that non-depositary financial institutions "shall not be located within 5,280 feet (one mile) of the same type of use inside or outside of Sandy City geographical boundaries.").

[168] Ordinance No. 3147,§ 11.2(c)(1), Sachse Texas, July 6, 2007.

[169] Griffith, Hilton, & Drysdale, *supra* note X, at 29.

moratoriums prohibiting new locations while they study and debate how to respond to predatory lending.[170]

Unfortunately, each of these zoning strategies suffers from systemic weakness. Almost without exception zoning restrictions have provided too little protection, too late. Local governments have established limits on the number of locations after the predatory lenders already saturated the City, town, or county with outlets. Indeed, this saturation has typically served as the political the impetus for the ordinance in the first place.[171] Most local governments have felt compelled to grandfather in existing locations, which effectively cements the unsatisfactory development pattern in place for the long term.[172] Moreover, minimum distance restrictions on predatory lender locations may look good on paper but actually provide minimal inhibition of the lenders' business models. Payday lenders themselves report in their Securities Exchange Commission disclosures that they generally attempt to locate within three miles of their target demographic.[173] Virtually all the distance limits adopted in the United States are too small to impede the basic business model of predatory small loan businesses. Zoning barriers to entry may, in effect, actually serve only to inhibit whatever minimal competition exists within the predatory lending market. While excluding payday or car title lenders from some favored districts may be cosmetically appealing, it does little to protect vulnerable citizens from financial predators. Ironically, many of the zoning restrictions only serve to "force" predatory lenders to locate in the poor, often minority neighborhoods and strip malls that they wanted to operate in anyway.

But perhaps the most unsatisfactory result of local ordinances is their propensity to demobilize efforts for more meaningful change. Zoning ordinances have been relatively easy to pass precisely because predatory lenders do not view these rules as a threat to their activities. In reality, while zoning ordinances do very little to protect vulnerable families from abusive financial products, they do provide political cover for leaders that do not want to risk offending the powerful predatory finance lobby. Well intentioned local governments can declare a "victory," congratulate

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[170] *See, e.g.*, Ruth Ingram, *Business Bans Still In Effect in Clinton*, Clinton-Ledger (Jackson, Miss.), March 15, 2010, A9 (discussing Clinton, Mississippi moratorium on new payday loan stores).

[171] Tim Jones, *States to Payday Lenders: Denied: Governments Curb Loan Operators that Have Grown So Much they Outnumber McDonald's Outlets*, Chicago Trib., March 23, 2008, C3.

[172] *See, e.g.*, Ordinance No. 10-1626, §(2)(D) Norwalk, California (February 23, 2010) ("Any payday loan establishment lawfully existing prior to the effective date of the ordinance that codifies this section and which is licensed by the City of Norwalk, shall be allowed to remain on the same property . . . .").

[173] *See, e.g.*, Check Into Cash, Inc., Registration Statement Form S-1, at 33 (July 31, 1998), http://www.sec.gov/Archives/edgar/data/1067289/0000931763-98-001978.txt.

themselves with an article in the local newspaper, and leave the basic underlying problem unsolved. There is little indication that these zoning ordinances have been part of effective campaigns building toward more lasting and meaningful legal changes. [174]

V. PLAINSPOKEN LEADERSHIP: A PROPOSAL FOR CAUTIONARY SIGNAGE ORDINANCES

This Part proposes a local ordinance strategy through which local leaders could both provide meaningful consumer protection and send a strong message mobilizing their community toward traditional limits on predatory loans. Appendix A, which follows this Article, includes a Model Small Predatory Lending Ordinance. This ordinance proposes that local governments require a cautionary message on signs at businesses offering credit at annual percentage rates exceeding 45%.[175] The signage requirements of the proposed small predatory lending ordinance are divided into two different types.

First, the ordinance requires that all of the exterior signs at a predatory lending business carry a local government cautionary message. For example, an ordinance adopted by the city of "Anywhere" would read: "City of Anywhere Warning: Predatory Lender."[176] The ordinance requires the display of this cautionary message over a third of the spatial area on each exterior sign.[177] The ordinance requires that the text of the cautionary message be black on a white background.[178] While proposed ordinance requires predatory lenders display the warning on any of their exterior signs, the warning is not required if the lender forgoes exterior signage.[179] Thus, the warning requirement is tailored to match the degree to which a predatory lender advertises at its location. The amount of required warning signage matches the amount of predatory lending advertisement chosen by the predatory lender.

Second, the ordinance requires the display of official door signs created and distributed by the director of a city or county department charged with enforcing the ordinance.[180] The ordinance requires display of these door signs on all exterior doors of a predatory lending facility. These official

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[174] It is worth noting that the proposed model ordinance included in Appendix A is not mutually exclusive with other existing local ordinances. Local governments that have already adopted zoning restrictions should also consider adapting the proposed model ordinance to fit within their existing law.

[175] *Infra* Appendix A, at § 600.

[176] *Id.* at § 600(b).

[177] *Id.*

[178] *Id.*

[179] *Id.* § 600 *official comment* 2.

[180] *Infra* Appendix A, § 600(c), (d).

door signs include the cautionary message in the same color and font pattern as the warnings displayed on the lender's existing exterior signs.[181] But, the cautionary door sign also includes an additional explanation indicating that: the city or county in question has determined that the facility displaying the sign engages in predatory lending; that the local government required predatory lending warnings on displayed signs under a consumer protection law; that the lender offers loans at interest rates above 45%; and, a statement indicating that "These loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship."[182]

In addition to signage requirements, the proposed ordinance includes a few other features designed to defend and enforce the ordinance. With respect to the former, predatory lenders are likely to challenge this ordinance in court. To this end, the proposed ordinance included legislative findings based upon empirical research regarding the consequences of predatory lending.[183] The model ordinance includes official comments that explain the various provisions of the statute, including graphic illustrations of the ordinances' signage requirements.[184] With respect to enforcement, the model ordinance requires all businesses lending at annual percentage rates in excess of 45% obtain a permit.[185] The permit requirement includes a licensing fee to cover the cost of enforcement of the ordinance and to generate revenue for the city or county.[186] The proposed ordinance allows either the local government agency charged with enforcing the act or former borrowers to bring lawsuits to enforce the ordinance.[187] Similar to federal consumer protection laws, the ordinance instructs courts to award modest statutory damages, court costs, and reasonable attorney fees to the local government or private plaintiffs that succeed in an enforcement law suit.[188]

There is no question that predatory lenders will be incensed by the proposed predatory small loan ordinance suggested in this Article. But, their visceral reaction is born from the painful reality of their commercial behavior. The truth of what these businesses have become is hurtful. Despite their public relations and government lobbying efforts to the contrary, lenders that charge exorbitant interest rates to American families are false friends of the working poor and middle class. While these lucrative companies have, in many instances, invested their profits in forging their polished corporate brands, local government leaders are under no obligation

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[181] *Id.* at § 600(e).
[182] *Id.*
[183] *Id.* at § 200.
[184] *Id.* at § 600 *official comment* 3.
[185] *Infra* Appendix A, at § 500(a).
[186] *Id.* at § 500(b).
[187] *Id.* at § 700(b), (c).
[188] *Id.*

to play along with efforts to camouflage abusive loans. Indeed, as President Regan once explained, "To grasp and hold a vision, to fix it in your senses -- that is the very essence, I believe, of successful leadership…."[189] The proposed ordinance in this section is useful because it provides a reoccurring, simple, and boldly featured message of warning to potential victims of abusive commercial behavior. Instead of confusing, numeric information that many Americans cannot understand, [190] the proposed ordinance clearly signals the danger associated with predatory loans. High cost lenders will object to this warning not because it is inaccurate, but because they realize its power and effectiveness.

A. *Why Forty-five Percent? Choosing a Clear, Justified, and Enforceable Bright Line*

The proposed model ordinance includes a clear and enforceable bright line price threshold of 45% APR for identifying predatory small loans. Forty-five percent is an appropriate threshold for at least two reasons. First, the characterization of loans at prices above this threshold as "predatory" reflects the policy objectives of federal law. Under current federal criminal law an annual actuarial interest rate in excess of 45% is considered one factor in establishing *prima facie* evidence that a loan is extortionate.[191] Extortionate lending is a serious crime punishable by up to 20 years in federal prison.[192] While there are, of course, additional elements present in the criminal prosecution of extortionate lending, the prima facie evidentiary threshold of 45% reflects Congressional judgment that prices above this interest rate are indicative of criminal, and by implication predatory, behavior.[193] In common usage the term "predatory" merely indicates that a behavior is inclined to injure or exploit for personal gain or profit.[194] For

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[189] Ronald Regan, Remarks at a Luncheon Hosted by Artists and Cultural Leaders in Moscow, Ronald Regan Presidential Library Archives, May 31, 1988 available at: http://www.reagan.utexas.edu/archives/speeches/1988/053188a.htm.

[190] Jeffrey Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Codification of Consumer Credit Contracts*, 63 VA. L. REV. 841, 920 (1977).

[191] 18 U.S.C.A. § 892(b)(2) (2011).

[192] *Id* at § 892(a).

[193] The conference report of the Consumer Credit Protection Act justifies the 45% evidentiary threshold thus:

> Section 892 is in no sense a Federal usury law. The charging of a rate in excess of 45 percent per annum is merely one of a set of factors which, where there is inadequate evidence to explain them, are deemed sufficiently indicative of the existence of criminal means of collection to justify a statutory inference that such means were, in fact, contemplated by the parties.

U.S. House of Representatives, Consumer Credit Protection Act Conference Report, Report No. 1397, 90th Congress, 2nd Session, p. 30, May 20, 1968.

[194] Merriam Webster's Dictionary.

over 40 years, federal law has held that loan prices in excess of 45% are indicative of illicit and exploitative intentions.[195] Because Congress has used this threshold as a legal device suitable, in part, for determining when high cost lenders should be incarcerated, it is also appropriate as a threshold in warning potential victims of the likelihood of this potentially criminal and predatory behavior.

Second, while the 45% evidentiary threshold in federal law does not, by itself, establish a criminal limit, many other federal and state laws both today and in the past, use an interest rate limit as the conclusive standard of illegal and in many states criminal behavior. For example, federal law establishes a 36% APR usury limit on loans made to military service members and their dependents.[196] In the recent past, all fifty states had usury limits on small consumer loans, typically at a price threshold much lower than the 45% threshold in this Article's proposed ordinance.[197] Currently, New York City, the nucleus of American finance, continues to do business without pause under the shadow of a strictly enforced criminal interest rate limit of 25%.[198] Georgia punishes violations of its usury limit with up to a year in prison.[199] Similarly, in Florida, the label "loan shark" is a legal term of art defined by statute.[200] Unlicensed lenders in Florida are guilty of misdemeanor "loansharking" when they willfully lend at annual interest rates in excess of 25%.[201] Unlicensed lending at interest rates of above 45% is punishable as a third degree felony.[202] If in all these jurisdictions, the government can sue and even imprison lenders for

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[195] Edward L. Rubin, *Legislative Methodology: Some Lessons From the Truth-in-Lending Act*, 80 GEO. L.J. 233, 261 (1991); Christopher L. Peterson, *Truth, Understanding, and High Cost Consumer Credit: The Historical Context fo the Truth in Lending Act*, 55 FLA. L. REV. 808, 879-880 (2003).

[196] John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a). 120 Stat. 2083,2266 (2006) (codified at 10 U.S.C. § 987(b)).

[197] Peterson, *Salience Distortion*, *supra* note X, at 1160–61.

[198] N.Y. PENAL LAW § 190.40 (McKinney 2011).

[199] GEORGIA CODE ANN. § 16-17-2(d) (2011).

[200] Fla. Stat. Ann. § 687.071(1)(f) (2011) ("'Loan shark' means any person as defined herein who lends money unlawfully under subsection (2) [or] subsection (3)….").

[201] *Id.* § 687.071(2) (Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take, or receive interest thereon at a rate exceeding 25 percent per annum but not in excess of 45 percent per annum, or the equivalent rate for a longer or shorter period of time, whether directly or indirectly, or conspires so to do, commits a misdemeanor of the second degree . . . .").

[202] *Id.* § 687.071(2) ("Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take, or receive interest thereon at a rate exceeding 45 percent per annum or the equivalent rate for a longer or shorter period of time, whether directly or indirectly or conspire so to do, commits a felony of the third degree . . . .").

victimizing borrowers with abusive pricing, surely it is also appropriate, indeed commendable, to *at least* provide an effective and prominent warning to borrowers that do not enjoy the benefit of comparable protections.

Given the tradition and current laws of many states that outlaw loans at interest rates lower than 45%, some local government leaders will view this threshold as set too high. Arguably, it would be more appropriate to set the threshold limit at 36% to mirror the most common American small loan limit throughout the twentieth century,[203] as well as the federal cap on loans to military service members.[204] Moreover, there are many financial practices that are fairly characterized as predatory independent of a 45% interest rate threshold.[205] For example, other abusive payday loan features and practices include: making loans without considering to borrowers' ability to repay; imposing balloon payments that force repeated refinancing; using checks or automated clearing house debit authorizations to coerce repayment; imposing pyramiding or otherwise excessive late fees; and charging excessive attorneys fees in the collection of small debts—all of which are independent of the loan's basically excessive price. Similarly, in the mortgage lending market, many subprime and exotic mortgage loans were predatory, not because of their interest rate, but because they targeted the value of the family's home or relied on flawed underwriting.[206] Nevertheless, while not every predatory loan has an interest rate of 45%, many local government leaders may reasonably conclude that every loan with an interest rate of 45% is predatory.

Questions are likely to be raised regarding whether a variety of consumer loans fall within the scope of the proposed model ordinance. For example, tax refund anticipation loans, unsecured finance company loans, and pawnshop loans can sometimes carry interest rates in excess of 45%. Importantly, all of these forms of credit can be offered with more modest prices when combined with responsible underwriting and reputable collection methods. But, insofar as federal Truth-in-Lending law characterizes these forms of credit as carrying an Annual Percentage Rate exceeding 45%, the model ordinance as written will require the same signage warnings that will almost certainly be imposed on typical payday and car title lending companies. Some lenders and merchants are likely to demand special exceptions under a proposed ordinance. However, making

[203] Peterson, *Salience Distortion*, *supra* note X, at 1142–43, 1161, .

[204] John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a). 120 Stat. 2083,2266 (2006) (codified at 10 U.S.C. § 987(b)).

[205] ELIZABETH RENUART, NATIONAL CONSUMER LAW CENTER, STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES 29-32 (2002).

[206] Patricia Sturdevant & William J. Brennan, Jr., *A Catalogue of Predatory Lending Practices*, 5 CONSUMER ADVOC. 4 (1999); H. Carr & Lopa Kolluri, *Predatory Lending: An Overview*, *in* FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 31, 32-35 (Fannie Mae Foundation 2001).

an exception for one type of merchant, practice, loan term, or another, will open the door to claims of an unlevel playing field. It will ultimately erode the clear, bright line that is one of the primary advantages of the ordinance. By hinging the ordinance on federal law, local governments would harness a pre-existing body of law that has already had many years of thoughtful interpretation by regulators and courts. In contrast, as language attempting to grant exceptions is introduced into the model ordinance, the likelihood of predatory lenders developing strategies to exploit loopholes will increase. A 45% Annual Percentage Rate trigger will provide a high, yet clear, bright line with low compliance costs for businesses and simple enforcement for both courts and local governments.

B. A Predatory Lender Warning Signage Ordinance is not Preempted by State Law

There is considerable variation in the powers granted to local governments to regulate commercial activity. Unlike sovereign state governments, courts regard local governments as administrative subdivisions of their states that do not have "inherent" powers.[207] Some local governments have "home rule" authority generally thought to include all powers not expressly denied by state statute.[208] Most jurisdictions follow "Dillion's rule," which holds that local governments have only those powers "granted in express words" together with those powers necessarily implied or essentially granted by statute.[209] Even under this more restrictive approach, most states have expressly granted local governments the broad authority to enact any laws or regulations that are "reasonably related" to the promotion of "health, safety, morals, peace, or general welfare."[210] Nevertheless, local governments may not enact ordinances which are inconsistent with state law or which infringe the spirit of state law.[211]

[207] 2 LOCAL GOVERNMENT LAW § 13:1 (2009 & supp.).

[208] *See, e.g.* City of Detroit v. Walker, 445 Mich. 682, 520 N.W.2d 135 (1994). Courts are, nevertheless, not in agreement on the nature of home rule powers. 2 LOCAL GOVERNMENT LAW § 13:3 (2009 & supp.). For further description of the law of home rule *see* DALE KRANE, PLATON N. RIGOS, & MELVIN B. HILL, JR., EDS. HOME RULE IN AMERICA: A FIFTY-STATE HANDBOOK (2001).

[209] Merriam v. Moody's Executors, 25 Iowa 163, 170, 1868 WL 253 (1868) (Dillon, C.J.); JOHN F. DILLON, MUNICIPAL CORPORATIONS § 55 (1872). The rule is named after John F. Dillon, an Iowa Supreme Court Justice and Columbia Law Professor. For a more detailed discussion of jurisprudence in Dillion's rule jurisdictions *see* 2 LOCAL GOVERNMENT LAW § 13:4- 13:9. For a critical analysis *see* Richard Briffault, *Our Localism: part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 7-11 (1990).

[210] *Id.*

[211] 2 LOCAL GOVERNMENT LAW § 13:6; Am. Jur. 2d Municipal Corporations § 315.

Generally speaking, a state statute preempts municipal ordinances when either the language in the ordinance contradicts the language in the statute or when the judiciary finds that the legislature intended to thoroughly occupy the field of regulation.[212]

Courts have consistently held that, in the absence of express or field preemption, local authority to regulate for the general welfare includes authority to regulate consumer finance.[213] Most directly, in the past some courts recognized the authority of local governments to directly cap interest rates on consumer loans.[214] Looking beyond the issue of price, courts have upheld local government authority to issue a wide variety of consumer financial services regulations. For example, Courts have generally upheld permitting requirements for pawnshops or other types of small consumer finance lenders.[215] Permit requirements are usually upheld even where the permit is duplicative of a state license.[216] And in some states the enforceability of contracts may be challenged where the lender failed to obtain a local permit.[217] By way of example, the Nebraska Supreme Court upheld the right of a local government to require that small lenders file detailed weekly reports on every loan made to a city auditor.[218] The Missouri Supreme Court held that local governments had the power to require that pawnbrokers take and maintain a photograph of each every customer pawning merchandise.[219] Moreover, courts have generally upheld ordinances requirement imposition of local per-transaction fees on consumer lenders.[220] Local law regarding consumer financial services can be enforced through criminal sanctions, even where those sanctions are

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[212] 56 Am. Jur. 2d Municipal Corporations § 316.

[213] McQuillin, 7 MUNICIPAL CORPORATIONS § 24:334 (3d. Ed. 2005 and Supp.)

[214] *See, e.g.,* City of Columbia v. Phillips, 85 S.E. 963, 963-64 (S.C. 1915) (upholding Columbia's 8% simple nominal annual interest rate limit).

[215] Iscoff v. Police Commision of City and County of San Francisco, 222 Cal.App.2d 395 (1st Dist. 1963); Medias v. City of Indianapolis, 23 N.E.2d (Ind. 1939); City of Rochester v. Bemel, 233 N.W. 862 (Minn. 1930); Provident Loan Soc. V. City and Coutny of Denver, 64 Colo. 400, 172 P. 10 (Colo 1918); City of Seattle v. Barto 71 P.735 (Wash. 1903). *See also* McQuillin, 9 Municipal Corporations § 26:154.3 (3d. Ed. 2005 and Supp.) (collecting and analyzing cases).

[216] Malish v. City of San Diego, 84 Cal. App. 4th 725, 101 Cal. Rptr. 2d 18 (4th Dist. 2000); City of new Orleans v. Heymann, 162 So. 582 (1935).

[217] *See generally* 29 ALR4th 884 (discussing failure of a lender to obtain a permit upon the enforceability of the lender's contracts).

[218] *See, e.g.,* Dougherty v. Commonwealth Co., 172 Neb. 330, 109 N.W.2d 409 (1961) (overruled in part on other grounds by, Gruenemeier v. Commonwealth Co., 178 Neb. 66, 131 N.W.2d 713 (1964)).

[219] Liberman v. Cervantes, 511 S.W.2d 835 (Mo. 1974). See also, Pawnmart, Inc. v. Gwinnett, 608 S.E.2d 639 (Ga. 2005) (upholding ordinance requiring pawnbrokers maintain fingerprints, digital photographs of customers).

[220] Wacksman v. Harrell, 189 N.E.2d 146 (OH. 1963).

complementary or duplicative of state statutes.[221] And most recently, some local ordinances attempting to address predatory mortgage lending have been upheld as a valid exercise of a local power where not preempted by state statute.[222]

Moreover, courts have traditionally regarded ordinances regulating signs as particularly within the authority of local governments.[223] For well over a hundred years local governments have been regulating merchants' outdoor advertising.[224] While authority to regulate signs is not unlimited, from early on Courts have deferred to local signage ordinances. For example, Chicago won multiple litigation battles with billboard advertisers in the early twentieth century.[225] Today there is an extensive jurisprudence granting local governments the power to regulate outdoor signs in virtually every state in the republic.[226] Sign ordinances of many different types and purposes are routinely upheld including limits on their location, construction, maintenance, size, and use.[227] A leading treatise explains, that signage ordinances "[a]re to be sustained upon the basis of promotion of the public safety, convenience, comfort, morals, and welfare of inhabitants; more specifically, they constitute a legitimate exercise of the police power. . . ."[228] While the laws of each state are different, a New York Court explained, that municipalities traditionally have "wide latitude" to adopt ordinances concerning outdoor signs which are "presumptively valid."[229]

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[221] City of Hobbs v. Biswell, 473 P.2d 917, 920 (N.M. App. 1970) ("With the enactment of [a state regulation] … there is regulation of pawnbrokers by both the State and the municipality. The fact of double regulation does not result in the withdrawal of the municipality's authority to regulate. An ordinance may duplicate or complement statutory regulations.").

[222] Am. Fin. Services Assn. v. Toledo, 830 N.E.2d 1233 (6th Dist. Lucas County, Ohio, 2005). *But see* American Financial Serivces Ass'n v. City of Oakland, 104 P.3d 813 (Cal. 2005) (city ordinance regulating predatory mortgage loan contractual terms preempted by state finance laws).

[223] Scadron v. City of Des Plaines, 606 N.E.2d 1154, 1159 (Ill. 1992).

[224] Cunningham, *Billboard Control Under the Highway Beautification Act of 1965*, 71 MICH. L. REV. 1925, 1346 (1973).

[225] City of Chicago v. Gunning System, 73 N.E. 1035 (1905); Thomas Cusack Co. v. City of Chicago, 108 N.E. 340 (Ill. 1915) *aff'd* 242 U.S. 526 (1917) (Ill. cities have authority to regulate billboards within city limits).

[226] McQuillon, 7 Municipal Corporations § 24:379 (3d ed. 2005 & supp.) (collecting cases).

[227] *Id.*

[228] *Id.*

[229] Village of Larchmont v. Sutton, 30 Misc.2d 245, 217 N.Y.S.2d 929, 934 (Sup 1961). It is perhaps worth mentioning that Thomas Mathews' influential treatise on model Municipal Ordinances includes extensive regulations of all types of signs. THOMAS A. MATHEWS, BYRON S. MATHEWS, AND JUDITH O'GALLAGHER, 4 MUNICIPAL ORDINANCES: TEXTS AND FORMS, ch. 51 (3d. ed. 2010 Revised).

Given the strength of authority granting local governments the power to regulate both consumer finance and outdoor signage, it is unlikely that courts will find either express or field preemption of the model small loan ordinance included in Appendix A. The very existence of over 130 zoning ordinances specifically targeting high cost, small loan lenders illustrates that state governments have not occupied the field of regulation over these lenders in every respect. Local governments continue to have broad zoning authority over consumer lenders because, like signage, this method of regulation is a matter of traditional local authority. Existing state regulations generally concern only the substantive terms and paperwork associated with loans. A few states require the display of loan prices or the contact information of state regulators inside lenders' businesses.[230] Virtually no states have adopted consumer financial regulation on the *exterior signage* of lender locations. Moreover, a cautionary exterior signage ordinance does not contradict either the express provisions of state consumer protection statutes. Legislatures that have adopted even the most anemic state payday and car title lending laws have generally included laudatory language in their legislation on the importance of consumer protection. A strongly worded local cautionary signage ordinance is consistent with the spirit of that public policy. Given the wide latitude traditionally given to local governments to regulate outdoor signs, courts should not hold that a local cautionary signage ordinance is preempted by the law of most states.

C. A Predatory Lender Warning Signage Ordinance is Constitutional

The First Amendment states that "Congress shall make no law . . . abridging the freedom of speech."[231] In addition to Congress, the Fourteenth Amendment imposes the First Amendment's freedom of speech restrictions on state and local governments.[232] The constitutional freedom of speech is a reflection of the American people's "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open."[233] Nevertheless, not all forms of speech are treated the same under the Constitution. There are two potential lines of cases that courts might use to analyze the constitutionality of the proposed cautionary signage ordinance: first, the government speech doctrine, and second, the compelled commercial speech doctrine.[234] With respect to the former,

[230] *See, e.g.,* Utah Code Ann. 1953 § 7-23-401(1) (requiring lenders post "a number the person can call to make a complaint to the [Utah Department of Financial Institutions] regarding the deferred deposit loan.").
[231] U.S. CONST. amend. I.
[232] Gitlow v. People of the State of New York, 268 U.S. 65, 666 (1925).
[233] N.Y. Times Co. v. Sullivan, 376 U.S. 254, 270 (1964).
[234] Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 652 (1985).

"[t]he government-speech doctrine is relatively new, and correspondingly imprecise."[235] Courts are still gradually sorting out the criteria that will define when a communication constitutes the government's own speech communicated with the assistance of private parties and private speech that the government compels. Moreover, there does not appear to be a consensus on the Supreme Court as to what distinguishes these forms of constitutional analysis.[236] Both types of government action are potentially constitutional, but the analysis and scrutiny applied by the Supreme Court differs. This section argues that the proposed cautionary signage ordinance is best viewed as constitutionally permissible government speech. But, even if courts determine that the warning signs are private speech, the ordinance is nonetheless a constitutional form of compelled commercial speech.

i. The Government Speech Doctrine.

The proposed cautionary signage ordinance engages in constitutionally permissible government speech. In recent years the United States Supreme Court has explained that "the Government's own speech . . . is exempt from First Amendment scrutiny."[237] The First Amendment precludes government from impermissibly restricting the freedom of speech, but it does not preclude the government from speaking. Thus, "[a] government entity has the right to 'speak for itself.'"[238] Indeed, government is "entitled to say what it wishes" and "to select the views that it wants to express."[239]

There are several examples of courts approving local government textual displays under the government speech doctrine. Most prominently, in *Pleasant Grove City v. Summum* the U.S. Supreme Court held that a monument reciting the Ten Commandments was a form of government speech not subject to First Amendment scrutiny.[240] A small religious group,

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[235] Johans v. Livestock Marketing Ass'n, 554 U.S. 550, 574 (2005) (") (Souter, J. dissenting).

[236] For example, *compare* Johans, 554 U.S. at (Souter, J., dissenting) ("[A] compelled subsidy should not be justifiable by speech unless the government must put that speech forward as its own.") *with* (the correct focus is not on whether the ads' audience realizes the Government is speaking . . . . As we hold today, respondents enjoy no right not to fund government speech—whether by broad-based taxes or targeted assessments, and whether or not the reasonable viewer would identify the speech as the government's." Johans. 554 U.S. at 564 n.7. *See also* Pleasant Grove City v. Summum, 555 U.S. 460, 481 (2009) (Stevens, J., concurring) ("To date our decisions relying on the recently minted government speech doctrine have been few and in, my view, of doubtful merit.").

[237] Pleasant Grove City v. Summum, 555 U.S. 460, 468 (2009) (*quoting* Johanns, 544 U.S. at 562).

[238] Pleasant Grove City v. Summum, 555 U.S. 460, 468 (2009) (*quoting* Board of Regents of Univ. of Wis. System v. Southworth, 529 U.S. 217, 229 (2000).

[239] Pleasant Grove City, 555 U.S. at 467-68 (citations and internal quotations omitted).

[240] *Id.* at 480-81.

called Summum, challenged Pleasant Grove City when the city refused to allow the creed to donate their own religious monument for display alongside the City's Ten Commandments monument.[241] While the case also raised questions under the establishment clause, the Court granted certiorari specifically to analyze the right of governments to speak.[242] Justice Alito, writing for the majority, emphasized that "governments have long used monuments to speak to the public."[243] The court explained that although city parks create a public forum for some purposes, no First Amendment values were offended by the government's selective display of a religious monument.[244]

Although *Pleasant Grove City* dealt with a local government's permanent monument, lower courts have applied the same doctrine to more temporary local government textual displays. For example, in *Downs v. Los Angeles Unified School District*[245] the U.S. Court of Appeals for the Ninth Circuit reviewed a public school teacher's constitutional challenge of school officials' refusal to allow him to post materials on a bulletin board reflecting differing viewpoints on the school's gay and lesbian awareness month.[246] A Los Angeles public school maintained a school bulletin board where faculty and staff could post materials.[247] Typical messages included content emphasizing acceptance of diversity and opposing bullying.[248] The school principal refused to allow the teacher to maintain a separate billboard with material challenging the morality of homosexual and lesbian behavior.[249] The Ninth Circuit held that the school's sign was government speech and therefore immune from First Amendment scrutiny.[250] "Viewpoint neutrality" analysis did not apply "because it . . . [was] a case of the government itself speaking."[251]

Similarly, a third case dealt with the Tobacco industry's challenge of a state government's imposition of a surtax on cigarette sales to fund an anti-tobacco advertising campaign that included billboard messages along with radio, television, and print advertising.[252] Among other messages, the advertising campaign included television advertisements displaying the text

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[241] *Id.* at 464-66.
[242] *Id.* at 482 (Scalia, J., concurring).
[243] *Id.* at 470.
[244] *Id.* at 481.
[245] 228 F.3d 1003 (9th Cir. 2000).
[246] *Id.* at 1005.
[247] *Id.* at 1005-06.
[248] *Id.* at 1006.
[249] *Id.*at 1006-07.
[250] *Id.*at 1013 ("We conclude that when a public high school is the speaker, its control of its own speech is not subject to the constraints of constitutional safeguards and forum analysis . . . .").
[251] *Id.* at 1011.
[252] R.J. Reynolds Tobacco Co. v. Shewry, 423 F.3d 906, 912 (9th Cir. 2005).

"WARNING: The tobacco industry is not your friend" and "WARNING: Some people will say anything to sell cigarettes."[253] Rejecting the application of the compelled speech doctrine, the Court instead applied the government speech doctrine in finding the speech constitutional.[254]

A more difficult question arises in determining what communications are government speech when there is some combination of private and public action. However, the government "is not precluded from relying on the government speech doctrine merely because it solicits assistance from nongovernmental sources."[255] The Supreme Court has held that "[a] government entity may exercise this same freedom to express its views when it receives assistance from private sources for the purpose of delivering a government –controlled message."[256] Similarly, the government may speak without First Amendment scrutiny where it "regulate[s] the content of what is or is not expressed . . . when it enlists private entities to convey its own message."[257] For example, in *Pleasant Grove City* the Supreme Court considered the Ten Commandments monument at issue government speech even though private citizens fabricated and donated the sign itself.[258] Similarly, in *Johans v. Livestock Marketing Association*, the Supreme Court reviewed a Congressional program forcing farmers to subsidize a government advertising campaign promoting beef. [259] Despite the compelled private support for the program and the use of private entities in producing the advertising campaign, the Court nonetheless upheld the program as government speech.[260]

The key criteria announced by the court in distinguishing government from private speech are whether the government "'effectively controlled' the messages sent" and whether the government is "exercising 'final approval authority' over their selection."[261] A federal district judge has emphasized that "[t]he determination as to whether speech is properly characterized as government speech or private speech turns entirely on "who is responsible for the speech."[262] Several Supreme Court Justices have also emphasized that government speech is immune from First Amendment scrutiny only where it is clear that the government is speaking, as opposed

[253] *Id.*
[254] *Id.* at 920.
[255] Johans, 544 U.S. at 562.
[256] *Pleasant Grove City*, 555 U.S. at 468.
[257] Rosenberger v. Rector and Visitors of Univ. of Va. 515 U.S. 819, 833 (1995).
[258] *Pleasant Grove City*, 555 U.S. at 464-65.
[259] Johans, *554* U.S. at 553-55.
[260] *Id.*
[261] Pleasant Grove City, 544 U.S. at 473 (quoting Johanns, 544 U.S. at 560-561).
[262] R.J. Reynolds Tobacco Company 272 F.Supp.2d at 1100.

to a private party.[263] The government is not allowed to avoid electoral accountability for its speech by concealing its message within the voice of private entities.[264]

In the proposed cautionary signage ordinance, a local government adopting the ordinance would "effectively control" the message conveyed in the municipal signs because the language of the signs is crafted within the city or county's legislative process. Indeed, there is even greater government control under the proposed ordinance than either in *Pleasant Grove City* or *Johans.* In the former, the sign itself was created and donated by private citizens.[265] In the latter, the Court held that beef advertising campaign was government speech even though the advertisements were produced and directed by private contractors, subject to approval by the government. In the case of the proposed ordinance, the government not only effectively controls the message, indeed, it completely controls it by permitting no language other than the words the city or county government itself has spoken.

Moreover, there is no question but that the cities and counties adopting the proposed ordinance would exercise final approval authority over the cautionary signs by voting in the legislative process to speak the very message adopted by the ordinance. Just as Pleasant Grove City had final approval authority on whether to display the donated Ten Commandments monument, so to would local governments have final approval on the precise wording and format of predatory lender warning signs. In both the *Pleasant Grove* and the proposed ordinance a local government is displaying language that it approves of and is accountable for.

While it is true that predatory lenders are likely to object to the message of the cautionary signage ordinance, there is no requirement of viewpoint neutrality in the government speech doctrine as applied to the proposed ordinance. High cost lenders have no right to force the government to only say things that lenders agree with. As Justice Scalia has observed, "it is the very business of government to favor and disfavor points of view."[266] There is no credible argument that by speaking to citizens in its own voice, local governments will close off a public forum of debate, since predatory lenders are free (and entirely likely) to respond vigorously with their own views.

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[263] *See* Johanns, 544 U.S. at 568 (Thomas, J., concurring) ("The government may not, consistent with the First Amendment, associate individuals or organizations involuntarily with speech by attributing an unwanted message to them, whether or not those individuals fund the speech, and whether or not the message is under the government's control."), *and Id.* at 569 (Ginsburg, J., concurring in judgment) ("I resist ranking the promotional messages funded under . . . [an Act of Congress], but not attributed to the Government, as Government speech . . . .").

[264] *Id.*

[265] *Pleasant Grove City*, 555 U.S. at 464-65.

[266] National Endowment for the Arts v. Finley, 524 U.S. 569, 598 (1998) (Scalia, J., concurring in judgment).

Similar to the school bulletin board in *Downs v. Los Angeles Unified School District*, in the case of the proposed cautionary signage ordinance "we do not face an example of the government opening up a forum for either unlimited or limited public discussion."[267]

Furthermore, the proposed signage ordinance poses no risk that the source of the government speech will be misattributed to a non-governmental speaker. The signage ordinance's warning is "clearly identified as coming from the government itself."[268] To further emphasize the government as the source of the speech, the ordinance calls on the government to use its official municipal seal to visually reinforce that the language is the government speaking rather than the lender or some other private entity. There is no risk that the public will be unable to decipher the source of the cautionary message and thereby be frustrated in electoral efforts to hold the government accountable for its speech.

Predatory lenders will perhaps argue that the fact that warnings are displayed on private property precludes application of the government speech doctrine.[269] However, nothing in the Supreme Court's jurisprudence on government speech points to the physical location of the speech as dispositive. Rather the Court has focused on the government's control of the message and final approval of content as the defining characteristics of government speech. Indeed, in *Johans v. Livestock Marketing* the Court found that the beef advertising campaign was government speech even though the advertisements were produced by marketing firms on private property, broadcast from private television and radio stations, and viewed in private homes and private businesses. The proposed ordinance's use of existing signage is best viewed from a Constitutional perspective as government speech that "merely . . . solicits assistance from

[267] Downs, 228 F.3d at 1012.

[268] R.J. Reynolds Tobacco Co., 423 F.3d at 920.

[269] For those local governments unwilling to risk a First Amendment challenge, another policy option would be simply installing government created, owned, and maintained warning signs as close as possible to predatory lending locations. Most American cities and counties retain ownership of a small strip of land separating public roads from merchants' private property. Such a strategy would be the surest ordinance to survive constitutional challenge because it would avoid any the use of any private action or property. Moreover, the cost of designing, installing and maintaining warning signs could be raised from revenue generated through predatory lending permit fees. There mere fact that predatory lenders would have to pay for government warning signs would not detract from the constitutionality of the ordinance because "compelled funding of government speech does not alone raise First Amendment concerns." Johans, 554 U.S. at 559. Moreover, this analysis is altogether unaffected by whether the funds for the warning signs are "raised by general taxes or through a targeted assessment. Citizens may challenge compelled support of private speech, but have no First Amendment right not to fund government speech. And that is no less true when the funding is achieved through targeted assessments devoted exclusively to the program to which the assessed citizens object." *Id.* at 562.

nongovernmental sources."[270] If adopted Courts should view the proposed ordinance "as an avenue for the representation of citizens' higher-minded desires even when as consumers they act with perhaps lower-minded motives."[271]

ii. The Compelled Commercial Speech Doctrine

Even if the Courts somehow decide that the proposed local government signs are private speech, the ordinance is nevertheless likely an example of constitutionally permissible compelled commercial speech. The core purpose of freedom of speech is to "assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people."[272] In furtherance of this purpose, the Supreme Court has most closely scrutinized what Robert Post has called "public discourse" the nature of which is "to ensure that a democratic state remains responsive to the views of its citizens."[273] While commercial speech also receives constitutional protection, the Court less closely scrutinizes this form of expression.[274]

Although the Court has had difficulty articulating the boundary between public discourse and commercial speech, in the seminal case of *Central Hudson Gas & Electric Corporation v. Public Service Commission*, the Supreme Court defined commercial speech as an "expression related solely to the economic interests of the speaker and its audience."[275] At other times the Court has pointed to "speech that *proposes* a commercial transaction" as the hallmark of commercial expression.[276] Additionally, other cases have pointed to speech constituting an advertisement, speech that refers to a product or service, and economically motivated speech as indicative characteristics of commercial expression.[277] Despite these attempts at

[270] Johans, 544 U.S. at 562.
[271] Abner S. Greene, *Government Speech on Unsettled Issues,* 69 FORDHAM L. REV. 1667, 1683–84 (2001).
[272] Roth v. United States, 354 U.S. 476, 484 (1957).
[273] Robert Post, *The Constitutional Status of Commercial Speech,* 48 UCLA L. Rev. 1, 4 (2000).
[274] *Cent. Hudson Gas & Elec. Corp.*, Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 562–63 (1980).
[275] 447 U.S. at 561.
[276] City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 423 (1993) (quoting *Fox*, 492 U.S. at 473–74)).
[277] Bolger v. Youngs Drug Products Corp., 463 U.S. 60, 66–67 (1983). *See also* Jennifer Pomeranz, *Compelled Speech Under the Commercial Speech Doctrine: the Case of Menu Label Laws*, 12 J. OF HEALTH CARE L. & POL'Y 159, 168 (2009).

defining commercial speech, the category of First Amendment analysis has been controversial and, in the view of some, inconsistent.[278]

Nevertheless, the Supreme Court has tolerated more aggressive government regulation of commercial speech for at least two reasons: "First, commercial speakers have extensive knowledge of both the market and their products. Thus, they are well situated to evaluate the accuracy of their messages and the lawfulness of the underlying activity. In addition, commercial speech, the offspring of economic self-interest, is a hardy breed of expression that is not particularly susceptible to being crushed by overbroad regulation."[279]

Furthermore, government action that merely compels speech, such as warnings or disclosures, receives less constitutional scrutiny than restrictions of speech. The Supreme Court has explained that "[c]ommercial disclosure requirements are treated differently from restrictions on commercial speech because mandated disclosure of accurate, factual, commercial information does not offend the core First Amendment values of promoting efficient exchange of information or protecting individual liberty interests."[280] The Supreme Court has not viewed the withholding of commercial information, that is, the right not to speak as a fundamental right where a commercial speaker is marketing her services.[281] In contrast to restrictions of speech, "disclosure furthers, rather than hinders, the First Amendment goal of the discovery of truth and contributes to the efficiency of the 'marketplace of ideas.'"[282] Accordingly, "less exacting scrutiny is required than where truthful, non-misleading commercial speech is

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[278] Post, *supra* note X, at 1 (explaining that commercial speech doctrine is "a notoriously unstable and contentious domain of First Amendment jurisprudence."). Former Chief Justice Rehnquist notably argued that commercial speech ought to receive no constitutional protection at all. *Id.* at 598-99 (Rehnquist, C.J .dissenting). Many scholars have agreed. Akhil Reed Amar, *Intratextualism*, 112 HARV. L. REV. 748, 812-18 (1999); C. Edwin Baker, *Commercial Speech: A Problem in the Theory of Freedom*, 62 IOWA L. REV. 1, 3 (1976); Lillian R. BeVier, *The First Amendment and Political Speech: An Inquiry into the Substance* and *Limits of Principle*, 30 STAN. L. REV. 299, 352-55 (1978).

[279] Proctor & Gamble Co. v. Amway Corp., 242 F.3d 539, 549 (5th Cir. 2001).

[280] National Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 113-14 (2d Cir. 2001). *See, e.g.*, 2 U.S.C. §434 (reporting of federal election campaign contributions); 15 U.S.C. §781 (securities disclosures); 15 U.S.C. § 1333 (tobacco labeling); 21 U.S.C. §343(q)(1) (nutritional labeling); 33 U.S.C. §1318 (reporting of pollutant concentrations in discharges to water); 42 U.S.C. §11023 (reporting of releases of toxic substances); 21 C.F.R. §202.1 (disclosures in prescription drug advertisements); 29 C.F.R. §1910.1200 (posting notification of workplace hazards).

[281] Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 652 (1985) (The right of a commercial speaker not to divulge accurate information regarding his services is not [] a fundamental right.").

[282] National Elec. Mfrs. Ass'n, 272 F.3d at 114.

restricted."[283] In sum, the First Amendment is satisfied "as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers."[284] The *Zauderer* majority explained that "in virtually all our commercial speech decisions to date, we have emphasized that because disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech, warnings or disclaimers might be appropriately required in order to dissipate the possibility of consumer confusion or deception."[285] In applying these constitutional principles, courts have upheld "[i]nnumerable federal and state regulatory programs [that] require the disclosure of product and other commercial information."[286]

The proposed predatory lender warning ordinance is properly viewed by Courts as compelled commercial speech. Unlike, for example, signs and billboards used in political election campaigns, the signs outside payday and car title lending locations are displayed entirely for commercial purposes. They are designed to solicit and encourage customers to borrow money. Moreover, the cautionary signage ordinance is itself designed to provide warning information to citizens that contemplate engaging in these entirely private transactions. The ordinance's compelled speech does not affect how people interact with the state, nor does it affect the communication associated with lenders' personal affairs. The ordinance also does not interfere with the relationship between borrowers and predatory lenders. Lenders remain free to, for example, charge ruinous interest rates to poor families. Moreover, the ordinance also does not attempt to prohibit or restrict any speech by predatory lenders.[287] Unlike many laws, such as advertising bans, the ordinance does not limit *any* speech by anyone. Rather, it merely adds a cautionary note authored by government as advice to borrowers of the significant risks of high interest rate loans. Notwithstanding the warning requirement, predatory lenders would remain free to continue advertising their services in any non-deceptive way they choose to do so. Nothing in the proposed ordinance requires lenders to

[283] Id. *See also* Riley v. Nat'l Fed'n of the Blind of N.C., 487 U.S. 781 (holding that "[p]urely commercial speech is more susceptible to compelled disclosure requirements" than is personal or political speech).

[284] Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 (1985). *See also* Milavetz, Gallop & Wilavetz, P.A. v. U.S., 130 S.Ct. 1324, 1328 (2010).

[285] Zauderer, 471 U.S. at 651 (citations, elipses, and original alterations omitted).

[286] *National Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 116 (2d Cir. 2001).

[287] *Cf* In re R.M.J., 455 U.S. 191, 203 (1982) (holding that government may not "place an absolute prohibition on certain types of potentially misleading information . . . if the information also may be presented in a way that is not deceptive."). *See also* Lyrissa Barnett Lidsky & Tera Jckowski Peterson, *Medium Specific Regulation of Attorney Advertising: A Critique*, 18 U. Fla. J.L. & Pub. Pol'y 259, 290-91 (2007) (pointing to disclosure requirements as a less-restrictive means of speech regulation on attorney advertising).

repeat an objectionable message out of their own mouths.[288] Indeed, Predatory lenders could counteract the local government's warning within their store signage itself. Given the triple digit interest rate profit incentives of predatory lenders, we should expect this type of counteractive speech to be just the sort of "hardy breed of expression" that Courts need not be overly concerned with stifling.[289]The consumer protection oriented nature of the ordinance is squarely within the policy goals at the heart of the subordinate constitutional protection of commercial speech.

The proposed ordinance is reasonably designed to counteract the confusing and deceptive speech of predatory lenders. As Professor Post has observed the Supreme Court has deployed weaker constitutional protection in "social settings that … involve persons who are deemed dependent, vulnerable, or not fully rational."[290] Part III of this essay set out empirical evidence of common behavioral patterns that inhibit the ability of borrowers to make rational and fully informed decisions in this market. It is reasonable for local governments to conclude that a provocative and prominent warning is needed to counteract the ability of predatory lenders systematically manipulate borrowers' less than fully rational behavior. Local governments are on a firm empirical foundation in believing that borrowers are unrealistically optimistic about their ability to repay high-cost debts aggressively marketed by predatory lenders.[291] At the most basic level, the very names of many leading lenders in this market are, arguably, misleading. Many lenders have names emphasizing speed, convenience, ease of access. Examples of small loan chains with this type of brand identity include: ACE Cash Express, Cash Loans Now, Cash N Run, Check 'n' Go, EZCash, FastBuck$, FastCash4You, Money Now, Quick Cash Financial Services, and SpeedyCash. It is not a coincidence that all of these brands emphasize "cash now" instead of "crushing interest payments later." Local government leaders would be reasonable in finding that many borrowers would benefit from a strong cautionary message because of borrowers' tendency to unwisely discount the value of future wealth and exhibit distress induced abbreviated reasoning patterns.

Moreover, local governments could reasonably conclude that many borrowers have great difficulty in processing and comparing even basic financial and legal information necessary to compare value in consumer finance.[292] While payday and car title lenders argue their contracts are

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[288] *See* West Virginia Bd. of Ed. v. Barnette, 319 U.S. 624, 632 (1943) (government may not compel children, contrary to their conscience, to salute the American flag).

[289] Proctor & Gamble Co. v. Amway Corp., 242 F.3d 539, 549 (5th Cir. 2001).

[290] Robert Post, *The Constitutional Status of Commercial Speech,* 48 UCLA L. REV. 1, 4 (2000).

[291] *See supra* notes X through X and accompanying text.

[292] *See supra* notes X through X and accompanying text.

simple, their contracts often impose many contingent and confusing fees and practices including "default rates," "service charges," "insufficient funds fees," "returned check fees," "collection costs," "late fees," "renewal fees," "court costs," "process service fees," "filling fees," and "attorneys fees."[293] For the millions of Americans that lack even basic qualitative and quantitative literacy these contracts are complicated and difficult to compare. Because default is common in the industry, these difficult to compare contingent fees are likely to have a greater effect on true costs in comparison to more mainstream financial products.

Many borrowers have virtually no incentive to comparison shop because they realize that they will not be able to spot the various tricks and traps predatory lenders lay for them in the inscrutable boilerplate legal provisions that accompany even relatively simple loans. A person of minimal quantitative and legal literacy may *rationally* recognize that the transactional costs of identifying which lenders have hidden tricks and traps within their adhesive boilerplate dwarf the potential utility from what may be a futile exercise in shopping. In a heterogeneously segmented market, there is no guarantee that *any* lender will offer a credit impaired borrower better terms, preferring to compete through aggressive collection practices instead of low transparent pricing. Moreover, borrowers' perception of the incentive to incur shopping costs may be informed by the fact that in many consumer contexts, the law allows the businesses to unilaterally change the terms of a consumer's deal after the fact anyway.[294] Even rational borrowers should discount the prospective benefit of shopping based on the realization that they have a very minimal chance of gaining access to counsel or a fair day in court to enforce those provisions of the agreement that might actually favor them.[295]

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[293] All fees are taken from sample payday loan contracts on file with author.

[294] Hilll v. Gateway 2000, Inc. 105 F.3d 1147, cert denied 522 U.S. 808 (Easterbrook, J); Regulation Z, § 226.9(c)(1); Alces and Greenfield, *supra* note X, at 1145; William J. Lawrence, *Rolling Contracts Rolling Over Contract Law*, 41 SAN DIEGO L. REV 1099, 1109 (2004).

[295] *Compare* Gene R. Nichol, *Judicial Abdication and Equal Access to the Civil Justice System*, Case Western Reserve L. Rev., UNC Legal Studies Research Paper No. 1551586 (Forthcoming, February 11, 2010), *available at* http://ssrn.com/abstract=1551586; Stephen B. Bright, *Legal Representation for the Poor: Can Society Afford This Much Injustice?*, 75 MISSOURI L. REV. 683 (2010); Russell Engler, *Connecting Self-Representation to Civil Gideon: What Existing Data Reveal About When Counsel is Most Needed*, 37 FORDHAM URB. L.J. 37 (2010); Russell Engler, *Pursuing Access to Justice and Civil Right to Counsel in a Time of Economic Crisis*, 15 ROGER WILLIAMS U. L. REV. 472 (2010); LEGAL SERVICES CORPORATION, DOCUMENTING THE JUSTICE GAP IN AMERICA: THE CURRENT UNMET CIVIL LEGAL NEEDS OF LOW INCOME AMERICANS, LEGAL SERVICES CORPORATION (September 2009) *available at*: http://www.lsc.gov/sites/default/files/LSC/pdfs/documenting_the_justice_gap_in_america_2009.pdf Robert A. Katzmann, *The Legal Profession and the Unmet Needs of the Immigrant Poor*, 21 Geo. J. Legal Ethics 3 (2008); DEBORAH RHODE, ACCESS TO JUSTICE 13 (2004);

Predatory lenders' best argument will be that the label "predatory" is so pejorative it cannot be characterized as commercial speech and is therefore subject to strict scrutiny. Although a few lower courts have attempted to argue that the *Zauderer* standard of scrutiny can only be applied to "uncontroversial information,"[296] the Supreme Court has primarily focused on whether warnings are accurate statements.[297] Thus the Court's insistence that: "The right of a commercial speaker not to divulge accurate information regarding his services is not such a fundamental right."[298] Local governments should argue that the word is an accurate description given the abusive commercial practices prevalent in this industry. The word "predatory" is commonly defined as "inclined . . . to injure or exploit others for personal gain or profit."[299] At least *eleven* different federal regulatory agencies have publically used the term "predatory" to describe some form of abusive lending.[300] The label is commonly used by scholars and the press in describing lending regulated by the ordinance.[301] Indeed, the word predatory has only come into common usage in recent years as a substitute for the adjective "criminal," which had been, and still is, used in many states to describe these loans for hundreds of years.[302] That Congress and many states have used a 45% interest rate as a criterion in establishing a loan's criminality is evidence that the term "predatory" is factual.[303] While the term predatory may exist at the outer bounds of commercial speech, this is factually appropriate for commerce at the outer bounds of legally acceptable behavior.

Jona Goldschmidt, *The Pro Se Litigant's Struggle for Access to Justice*, 40 FAMILY COURT REV. 36 (2002); C.E. SMITH, COURTS AND THE POOR (1991) *with* Gideon v. Wainwright, 372 U.S. 335, 344 (1962) (1963) (quoting Powell v. Alabama, 287 U.S. 45 (1932)) ("The right to be heard would be, in many cases, of little avail if it did not comprehend the right to be heard by counsel. Even the intelligent and educated layman has small and sometimes no skill in the science of law. . . . Left without the aid of counsel . . . he lacks both the skill and knowledge to adequately prepare his defense, even though he had a perfect one.").

[296] R.J. Reynolds Tobacco Company v. United States Food and Drug Administration, --- F.Supp.2d ----, 2011 WL 5307391, at *6 (D.D.C.)

[297] *Zauderer*, 471 U.S. at 651 n.14.

[298] *Id.*

[299] *Definition of predatory*, Merriam-Webster.Com, http://www.merriam-webster.com/dictionary/predatory (last visited Nov. 26, 2011).

[300] Peterson, *Federalism and Predatory Lending*, *supra* note X, at 5 (collecting examples).

[301] *See, e.g.*, Paul Davidson, Paul Wiseman and John Waggoner, *7Things that Helped Break the Economy … And How Congress Aims to Fix Them*, USA TODAY, June 28, 2010, 1B ("At the core of the spiral: No regulatory authority had sole responsibility for protecting consumers from predatory lending and other abuses.").

[302] *See infra* note X and accompanying text.

[303] *See infra* note X through X and accompanying text.

While criminality is not a standard courts use to judge the constitutionality of compelled speech, it would nevertheless be an odd constitution that allows government to incarcerate people to prevent predatory lending, but forbids government from deploying strongly worded warnings. Where a business solicits consumers to engage in a transaction widely treated as criminally abusive for nearly three hundred years, the Constitution ought not to require only uselessly insipid, wishy-washy, and milquetoast warnings. The constitution does not prevent the government from using "plain English" to warn vulnerable citizens about financial predators.[304] The judicial preference for decorum is not a constitutional requirement. Recognizing this point, Chief Justice Rehnquist explained that if courts hold otherwise, "[l]oan sharks might well choose States with unregulated small loan industries, luring the unwary with immune commercial advertisements." [305] Surely if the Chief Justice of the Supreme Court can label high cost, small loan lenders "loan sharks," local governments are on a firm rhetorical footing with the relatively restrained label of "predatory lender." As the former Chief Justice seems to have recognized, it is factually accurate to characterize lions, tigers, bears, and loan sharks as predatory.

VI. CONCLUSION

This Article has explored local government ordinances and resolutions that attempt to inhibit predatory lending within their communities. A growing trend of local government action has emerged following the failure of federal and state leaders to provide effective consumer protection laws. This vacuum in leadership on small, high cost loans has developed despite the great majority of Americans that support banning predatory loans. Federal and state preemption of local financial regulation have left local governments with limited authority to act on their constituents wishes.

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[304] *Hersh v. United States*, 553 F.3d 743, 767 (5th Cir. 2008) (upholding Congressional statute requiring that attorneys describe themselves as "debt relief agencies."). *See also* R.J. Reynolds Tobacco Co. v. Shewry, 423 F.3d 906, 911-12 (9th Cir. 2005) (upholding a cigarette surtax funded public advertising campaign that attacked "not the desirability of a product but … the moral character of [the] industry, accusing it of hypocrisy, cynicism, and duplicity.") *and* Commonwealth Brands, Inc. v. United States, 678 F.Supp.2d 512, 530 (W.D.Ky. 2010) (rejecting application of strict scrutiny to tobacco industry's First Amendment challenge to F.D.A. cigarette graphic-warning labels). *But see* R.J. Reynolds Tobacco Company v. United States Food and Drug Administration, --- F.Supp.2d ----, 2011 WL 5307391 (D.D.C.) (applying strict scrutiny to strike down the F.D.A.'s graphic cigarette warning labels).

[305] *Bigelow v. Virginia*, 421 U.S. 809, 835 (1975) (Rehnquist, Dissenting). Moreover, a search of the Westlaw's Supreme Court Decisions database indicates that the United States Supreme Court has used the term "predatory" in various criminal and civil contexts in at least 109 different published opinions.

However, because local governments have traditionally had broad authority to regulate merchants' exterior signage, this article suggests using that power to protect families from predatory loans. In particular, this Article proposes a model ordinance requiring that lenders offering loans with annual percentage rates in excess of 45% display a cautionary message that reads "Warning: Predatory Lender," on their street, storefront, and other on-premises exterior signs. While these signage requirements are in some respects unusual, this flows from the great disparity in the wishes of the public and the law as it has come to be controlled by the powerful business interests that exert pressure on key financial services committees in state legislatures and Congress. Providing a strongly worded message of caution on exterior signs to warn predatory loan borrowers would allow local governments to seize the initiative to help vulnerable families. Given the strong empirical, historical, and moral evidence suggesting that predatory small loans are destructive for borrowers, their families, and our communities, local government leaders should use their offices to protect the citizens that elected them.

APPENDIX A. MODEL PREDATORY SMALL LOAN ORDINANCE

[Insert Jurisdiction] ORDINANCE No. ____
PREDATORY SMALL LOAN ORDINANCE

WHEREAS, there exist business practices, commonly referred to as "predatory lending", whereby businesses lend small sums of money at usurious and unconscionable interest rates to low and moderate income persons; and

WHEREAS, small predatory loans have an unreasonably adverse effect upon the elderly, young families, members of our armed services and their families the economically disadvantaged, and other citizens of [insert jurisdiction]; and

WHEREAS, many predatory loan borrowers lack bargaining power and financial experience and have difficulty evaluating the risks, prices, and consequences associated with high cost debts; and predatory loans cater to impulse borrowing that funds illicit drug use, gambling, and are otherwise deleterious of public thrift; and

WHEREAS, predatory lenders falsely advertise their loans as fast and convenient, when in fact many borrowers fall captive to protracted cycles of repeat borrowing; and

WHEREAS, predatory lending causes families to default on mortgage, rent, and utility payments, delay needed medical care, and, lose bank their accounts; and

WHEREAS, predatory lending locations increase crime; and

WHEREAS, usurious lending is immoral and contrary to the values of the residents of [insert jurisdiction]; and

WHEREAS, many less expensive and dangerous personal finance options are widely available to [insert jurisdiction] residents through banks, thrifts, credit unions, pawnbrokers, and merchants; and

WHEREAS, the federal government has determined that annual interest rates above 45% are indicative of predatory loan sharking; and

WHEREAS, predatory lending was illegal and a criminal act throughout most of American history, including all thirteen original states, and in the state of [insert state]; and

NOW, THEREFORE, BE IT RESOLVED that the City Council of [insert jurisdiction] ordains as follows:

PART I. Chapter [insert appropriate chapter] of the [insert jurisdiction] Code is hereby enacted to read as follows:

Table of Contents

Section 500. Licensing
Section 600. Signage
Section 700. Enforcement
Section 800. Severability

Section 100. Title for Citation

The ordinance codified in this chapter shall be known and may be referred to as the PREDATORY SMALL LOAN ORDINANCE.

Section 200. Legislative Findings

The [insert jurisdiction] Council finds as follows:

(a) There exist business practices, commonly referred to as "predatory lending", whereby businesses lend small sums of money at usurious and unconscionable interest rates to low and moderate income persons and target members of our armed services and their families; and

(b) Small predatory loans had an unreasonably adverse effect upon the elderly, young families, the economically disadvantaged, and members of our armed services and their families, and other citizens of [insert jurisdiction]; and

(c) Many predatory loan borrowers lack bargaining power and financial experience and have difficulty evaluating the risks, prices, and consequences associated with high cost debts; and predatory loans cater to impulse borrowing that funds illicit drug use, gambling, and are otherwise deleterious of public thrift; and

(d) Predatory lenders falsely advertise their loans as fast and convenient, when in fact many borrowers fall captive to protracted cycles of repeat borrowing; and

(e) Predatory lending causes families to default on mortgage, rent, and utility payments; delay needed medical care; and lose bank their accounts; and

(f) Predatory lending locations increase crime; and

(g) Usurious lending is immoral and contrary to the values of the residents of [insert jurisdiction]; and Many less expensive and dangerous personal finance options are widely available to [insert jurisdiction] residents through banks, thrifts, credit unions, pawnbrokers, and merchants; and

(h) The federal government has determined that annual interest rates above 45% are indicative of predatory loan sharking; and

(i) Predatory lending was illegal and a criminal act throughout most of American history, including all thirteen original states, and in the state of [insert state]; and

Official Comments:

1. The characterization of loans with exorbitant interest rates as "predatory" in subsection (h) is intended to reflect the policy objectives of federal law. Under current federal criminal law an annual actuarial interest rate in excess of 45% is considered *prima facie* evidence that the loan is extortionate. 18 U.S.C.A. § 892(b)(2) (2011). While there are additional elements present in the criminal prosecution of extortionate lending, the prima facie evidentiary threshold of 45% reflects Congressional judgment that prices above this interest rate are indicative of criminal, and by implication predatory, behavior. The term "predatory" reflects Congress' judgment that loans in excess of 45% are inclined to injure or exploit borrowers for personal gain or profit. Because this threshold is used by Congress as a legal device suitable for determining when high cost lenders should be incarcerated, it is also appropriate as a threshold in warning potential victims of the likelihood of this potentially criminal and predatory behavior. The characterization of loans with interest rates in excess of 45% as predatory is supportive of existing federal law by warning borrowers regarding interest rates that Congress considers *prima facie* evidence of extortionate loan sharking. Because loans with exorbitant interest rates can be characterized as extortionate for purposes of criminal law, they can also be characterized as predatory for purposes of consumer protection law.

Section 300. Definitions

As used in this Chapter unless the context requires otherwise:
(a) "Annual Percentage Rate" shall be defined in accordance with federal law.
(b) "Director" means the Director of the [insert appropriate administrative department].
(c) "Predatory Lender" means any person or entity that lends, brokers, or in any way extends a predatory small loan.
(d) "Predatory Lending Facility" means any location where a predatory lender conducts its business.
(e) "Predatory Small Loan" means an extension of credit made at an Annual Percentage Rate in excess of 45%.
(f) "Warning Sign" means a sign required by this ordinance which includes the language "[INSERT JURISDICTION] WARNING: PREDATORY LENDER."

Official Comments:

1. Subparagraph (a) and (e), in combination with section 600, indicate that this ordinance applies to all lenders that make extensions of credit in excess of an Annual Percentage Rate of 45%. Since this ordinance defers to federal law on the definition of an Annual Percentage Rate, the scope of this ordinance is coextensive with federal law as it is currently articulated in the Truth in Lending Act and Regulation Z. Insofar as a financial service does not carry an Annual Percentage Rate under federal law, the signage

requirements of this ordinance would not apply to that transaction. However, if federal law characterizes a service as imposing an annual percentage rate, the service is within the scope of this ordinance at the point that the rate exceeds 45%.

Section 400. Administrative Authority

(a) The Director is authorized and directed to enforce all provisions of this Chapter. The Director shall have the power to investigate any and all complaints regarding alleged violations of this Chapter. The Director may delegate any or all authority granted under this Section to any supervisor, employee, or agent.

(b) The Director is authorized to adopt and enforce administrative rules interpreting and applying this Chapter. The Director or designee shall make written findings of fact and conclusions of law to support all decisions.

(c) Prior to adoption of a new administrative rule, the Director shall give notice to all interested parties of the terms of the proposed rule, and shall conduct a public hearing to consider public comment. Public notices shall be given when administrative rules have been adopted.

(1) At the public hearing, the Director or designee shall hear oral and written testimony concerning the proposed rule. The Director shall have the power to establish and limit the matters to be considered at the hearing, to prescribe procedures for the conduct of the hearings, to hear evidence, and to preserve order.

(2) The Director or designee shall adopt, modify, or reject the proposed ruling after considering testimony received during the public hearing.

(3) Unless otherwise stated, all rules shall be effective upon adoption by the Director.

(4) The Director shall take reasonable and customary steps to make all final rules available to the public.

(5) Notwithstanding subsections (1) and (2) of this Section, the Director may adopt an interim rule without prior public notice upon a finding that failure to act promptly may result in serious prejudice to the public interest or the interests of the affected parties. Such interim rules shall detail the specific reasons for such prejudice. Any interim rule adopted pursuant to this paragraph shall be effective for a period not to exceed 180 days.

Section 500. Licensing

(a) Within 90 days of the effective date of the ordinance enacted in this Chapter, any predatory lender operating in [insert jurisdiction] shall apply for and obtain a permit to operate as a predatory lender. Permits shall be required for each location a lender operates in [insert jurisdiction] and shall

be renewed annually. The application shall be in a form to be determined by the Director or the Director's designee. No person shall operate a predatory lending business located in [insert jurisdiction] without a current permit to do business issued by [insert jurisdiction].
(b) The annual permit fee for each location shall be $10,000 in the first year following enactment of this ordinance. In each subsequent year following enactment of this ordinance the Director shall adjust the annual permit fee to account for inflation or deflation based on the Consumer Price Index as calculated by the United States Department of Labor Bureau of Labor Statistics or based on another comparable measure of price change designated by the Director.
(c) Predatory lending permits shall be required in addition to the [insert jurisdiction] business license required by section insert appropriate code section of the [insert jurisdiction] Code.

Official Comments:

The predatory lending permit requirement of this section is not intended to replace the normal business operating licenses customarily required by most cities and counties. Rather it is intended as an additional permit focused on businesses making high cost consumer loans. The purpose of this permit requirement is to assist the Director in monitoring compliance with the Predatory Small Loan Ordinance as well as to generate revenue to cover the operating costs of local government.

Section 600. Signage

(a) It is unlawful and a violation of this code for any predatory lender to operate a predatory lending facility, unless the premises where the predatory lending facility is operated with exterior signs conforming to the requirements of this section.
(b) All exterior signs displayed at the business location of a predatory lender shall be modified to include the [insert jurisdiction] disclosure statement: "[INSERT JURISDICTION] WARNING: PREDATORY LENDER." The [insert jurisdiction] disclosure statement shall substantially occupy 33% of the spatial area on all signs governed by this section. The 33% area allocated for the disclosure statement shall be composed of a black Arial all capitals text on a white background.
(c) Predatory lenders operating within [insert jurisdiction] shall obtain and display official [insert jurisdiction] predatory lending door signs on all exterior doors at any predatory lending facility.
(d) The Director shall design and distribute to predatory lending facility permit holders official [insert jurisdiction] predatory lending door signs. The predatory lending door sign shall be designed to be visible by persons entering the predatory lending facility. The predatory lending door sign

shall be designed to substantially occupy the entire spatial area of exterior doors at predatory lending facility. The director shall, in its discretion, have the authority to provide different types of official predatory lending door signs to accommodate mounting such signs on different types of exterior doors, so long as these variations are otherwise in compliance with the requirements of this section.
(e) Official [insert jurisdiction] predatory lending door signs shall have black Arial all capitals text with a white background. Such door signs shall display the disclosure statement: "[INSERT JURISDICTION] WARNING: PREDATORY LENDER." In addition, the official door sign shall include the following explanatory comment: "[Insert jurisdiction] has determined that this facility engages in predatory lending. [Insert jurisdiction] has required this lender to display consumer protection warnings. This predatory lending facility lends at interest rates above 45%. These loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship."
(f) All signs required by this section shall display the [Insert Jurisdiction] official seal.

Official Comments:

1. The purpose of this section is to warn consumers about the risks associated with small predatory loans. Many predatory loan borrowers lack bargaining power and financial experience and have difficulty evaluating the risks, prices, and consequences associated with high costs debt. Moreover, many predatory lenders inaccurately characterize their loans as fast and convenient even though these loans often lead borrowers into captive to protracted cycles of repeat borrowing lead. The warning signs in this section will serve to alert consumers to use caution when dealing with predatory lenders.

2. The warning signs required by subsections (b) and (c) are designed to make it clear to potential borrowers that the language employed is a communication from [insert jurisdiction]. The only warning that is required by [insert jurisdiction] are the exterior door signs required by subsection (c). However, if a predatory lending facility chooses to display additional signage at their business location, subsection (b) requires that these additional signs include a warning statement echoing the warning provided by official exterior door signs. This requirement is narrowly tailored to match the degree to which a predatory lender advertises at its location. The amount of required warning signage matches the amount of predatory lending advertisement chosen by the predatory lender.

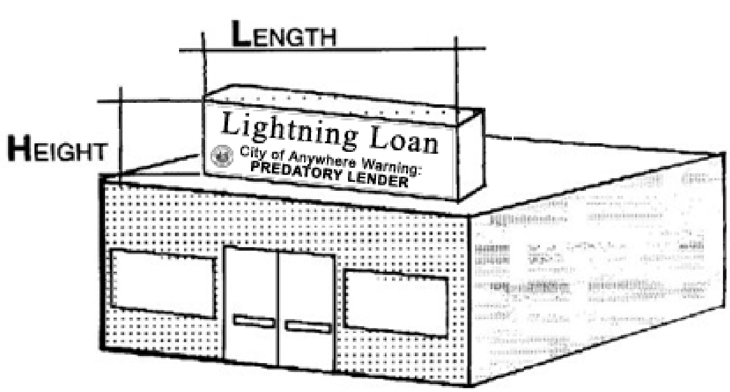
3. Predatory lending facilities may have various types of pre-existing signage. Subsection (b) does not require a single authorized sign design, except as specified by the requirements of this section. To assist predatory

lenders in complying with subsection (b), this comment includes several illustrative examples:

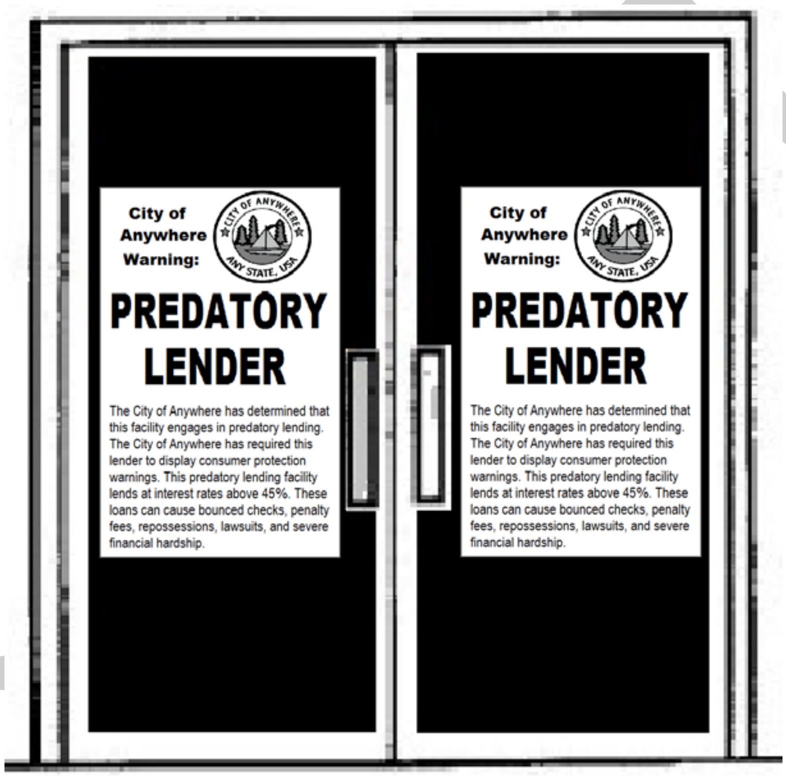
a. Monument sign:

b. Marquee sign:

c. Roof sign:



4. Subsections (d) and (e) give the Director discretion to design the official [insert jurisdiction] exterior door sign. Official exterior door signs are required on all exterior doors in order to prevent predatory lenders from only placing the official exterior door sign on a door not regularly used by customers entering the predatory lending facility. The following illustration is an example of the door sign design contemplated by [insert jurisdiction].



Section 700. Enforcement

(a) The remedies provided herein are cumulative and supplementary and apply to licensees and unlicensed persons to whom this Ordinance applies even where they failed to obtain a permit as required.
(b) The Director shall have the authority to bring suit to enforce this Ordinance. A predatory lender found in violation of this Ordinance shall be liable for a statutory penalty of $10,000 per month per signage violation, together with any and all costs and attorney fees incurred by [insert jurisdiction] in enforcing this Ordinance.
(c) Any borrower who obtains a loan from a predatory lender in violation of this ordinance shall have the right to enforce the provision of this

ordinance through an individual or class representative lawsuit. A predatory lender found to have violated this ordinance shall be liable to each borrower for actual, consequential, and statutory damages of $2000 for each signage violation, together with costs and reasonable attorney fees, as well as any appropriate injunctive or other equitable relief. The remedies provided in this section are not intended to be the exclusive remedies available to borrowers nor must borrowers exhaust any administrative remedies provided by contract or any other applicable law.
(d) Any predatory lending facility operated, conducted, or maintained in violation of this ordinance or any other federal or state law shall be, and hereby is, declared to be unlawful and a public nuisance. The Director may, in addition to or in lieu of any other remedies set forth in this ordinance, commence an action to enjoin, remove or abate such nuisance in the manner provided by law and shall take such other steps and apply to such court or courts as may have jurisdiction to grant such relief.
(e) In each subsequent year following enactment of this ordinance the Director shall adjust the statutory penalty and damage provisions of subsections (b) and (c) to account for inflation or deflation based on the Consumer Price Index as calculated by the United States Department of Labor Bureau of Labor Statistics or based on another comparable measure of price change designated by the Director.

<u>Section 800. Severability</u>

If any portion of this ordinance is determined to be invalid for any reason by a final non-appealable order of any court of this state or of a federal court of competent jurisdiction, then it shall be severed from this ordinance. All other provisions of this ordinance shall remain in full force and effect.