2-2014

Public Opinion and the Limits of State Law: The Case for Federal Usury Caps

Nathalie Martin
University of New Mexico - School of Law

Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap

NATHALIE MARTIN[1]

---

1. Frederick M. Hart Chair in Consumer and Clinical Law, University of New Mexico School of Law. The author thanks the University of New Mexico School of Law for its financial support, Ernesto Longa, Brian Parrish, Adam Reitz, and Sherri Thomas for their superb research assistance, and Stewart Paley, Fred Hart, David Herring, Robert Lawless, Pamela Foohey, David Stout, Amy Schmitz, Ocean Tama, Paul Chessin, Jonathan Reischl, Karen Meyers, and Jason Arvisu for their helpful editorial assistance.

I. INTRODUCTION

The time for a federal usury cap has come. Setting interest rate caps on consumer loans has historically been left up to the states,[2] yet states have been unable to legislate or enforce effective interest rate caps on consumer loans. Congress, on the other hand, has the capacity to efficiently and effectively enter this space, as it has in so many critical consumer and commercial law settings. Morever, despite the fact that Americans overwhelmingly believe there *should* be interest rate caps on consumer loans,[3] triple and quadruple-digit interest rate store-front loans and 1,000% Internet loans are now commonplace in the majority of American states. Online payday loans proliferate in all states, regardless of the laws of these states, despite herculean efforts on the part of state legislatures to enact laws and state courts to enforce those laws. Millions of taxpayer dollars have been spent in these battles, yet the result of states' attempts has been only inefficiency and waste.

There are several reasons for this waste. First, most states have not implemented any rate caps on consumer loans, despite their citizens' desire

2. Since the effective deregulation of interest rate caps in *Marquette National Bank v. First Omaha Service Corp.*, 439 U.S. 299 (1978), discussed further in Part II below, many states have dispensed with state usury caps.
3. *See infra* notes 50-64 and accompanying text.

for such caps.[4] Second, in states that *have* implemented laws regulating specific loan products, such as payday loans and title loans, lenders have used various work-arounds and loopholes to continue offering triple-digit interest rate loans. These work-arounds are embarrassingly easy to implement, either by changing the loan products to fall outside narrowly drawn existing regulation, by restructuring the loan provider to fit within an existing exception to usury caps, by teaming with Indian tribes in order to avail lenders of tribal sovereign immunity and avoid state laws, or by moving to an unregulated state to escape the reach of state laws.

Even in states with very simple, across-the-board interest rate caps on all loans, lenders still avail themselves of tribal and offshore options, or, in some cases, simply flagrantly violate the law without a loophole, making it necessary for consumers to sue them for the violation. Lenders then rely on broad anti-class action and arbitration clauses in contracts in order to escape liability.[5] The legislative and judicial waste created by these piecemeal battles leads to an inexorable conclusion: the efforts of states have largely failed.[6]

Indeed, the time has come to pass a federal usury cap for all Americans, similar to the one currently applicable to military personnel.[7] Con-

---

4. *See* Timothy E. Goldsmith & Nathalie Martin, *Interest Rate Caps, State Legislation, and Public Opinion: Does the Law Reflect the Public's Desires*?, 89 CHI.-KENT L. REV. 115, 116-17 (2014). In this Article, Professor Goldsmith and I explore public opinion about interest rate caps through empirical research. Here I use this data, my prior research on payday loan loopholes of various kinds, as well as unconscionability doctrine and case law, to conclude that we need a federal rather than a state solution to sky-high consumer loan interest rates.

5. *See infra* notes 186-90 and accompanying text.

6. Colorado is an exception in that it has been proactive in regulating payday loans without causing them to leave the state, thus attempting to balance consumers' and lenders' interests. *See* COLO. REV. STAT. §§ 5-3.1-101 to 5-3.1-123 (2011), *quoted in* Amy Schmitz, *Females on the Fringe: Considering Gender in Payday Lending Policy,* 89 CHI.-KENT L. REV. 65, 76-77 (2014). *See also infra* notes 95-107 and accompanying text (detailed discussion of Colorado's law).

7. *See* John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (2006) (codified as amended at 10 U.S.C.A. § 987(b) (West, Westlaw current through P.L. 113-74) [hereinafter MLA] (capping interest rates on payday loans, tax refund loans, and car title loans at 36%). *See also* Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649, 650 (2012). In this article, Professor Johnson argues that the civilian population is actually more vulnerable to ensnarement in predatory loans and less protected by a social safety net, so that the need for such protections for the military, as evidenced by the Military Lending Act (MLA), proves the need for the civilian population. *Id.* In addition to explaining these practices, the potential regulations, and the CFPB's authority to create such a regulatory framework, she argues that a multi-faceted

sumer borrowing is impervious to state borders, meaning that the entire country is a common consumer lending market. Moreover, states have no particular local interests in interest rate caps. There is a need for uniformity in interest rates across states, which only Congress can provide.

This Article calls on Congress to set a federal interest rate cap of 36%, applicable to all loans. [8] Part II of this Article briefly describes the history of usury laws in the United States and then describes the patchwork nature of modern usury law. Part III describes various types of consumer loans, including high-cost loans like payday and title loans. Part III then reviews evidence of public opinion regarding interest rate caps for consumer loans, showing that Americans of both political parties favor caps of 36% or less by a wide margin. Given the broad and deep public support for interest rate caps, the question is not whether but how to accomplish these caps.

Part IV, the heart of the Article, describes the many ways in which state regulation of high cost lending has been inefficient and ineffective. Part IV.A describes the various forms of legislation that have attempted but failed to lower interest rates and curb other abuses in high-cost lending. It describes in detail the many work-arounds used by lenders to avoid whatever state law is enacted. These work-arounds include changing loan products to get around narrow definitions in state statutes, morphing lenders into another type of entity to get around the state statutes, or moving to lending online through Indian tribe affiliation or offshore entities. Part IV.B describes the difficulties with trying to enforce state statutes through judicial means. It discusses the unconscionability doctrine and its resulting inconsistent case law, the delays caused by lender bankruptcy, the difficulties posed by recent Supreme Court law on the enforceability of anti-class action clauses and arbitration clauses in high-cost loan contracts, and finally, the mere cost of enforcement litigation as a whole.

Working toward finding a solution to this problem of state ineffectiveness in regulating high-cost credit, Part V describes Congress's power to regulate consumer credit as well as some of the general benefits of regulating at a federal as opposed to a state level. This section also describes one example of a federal usury cap enacted by Congress, the Military Lending Act, which caps interest at 36% for loans made to military personnel. This

---

strategy is needed to address the problem. Using its educational mandate, she suggests ways in which the CFPB can use social media and other techniques to foster expansion of affordable low-cost loans, which would be issued under a CFPB safe harbor provision. *Id.* at 670-75. Even the MLA has loopholes however. *See infra* notes 204-13 and accompanying text.

8. Others have also suggested the need for a federal usury cap. *See, e.g.*, Leah Plunkett & Ana Lucia Hurtado, *Small-Dollar Loans, Big Problems: How States Protect Consumers from Abuses and How the Federal Government Can Help*, 44 SUFFOLK U. L. REV. 31, 50-51 (2011) (stating that Congress should enact a federal usury cap of 36%); Johnson, *supra* note 7.

section describes how a similar but improved law could benefit all Americans. Finally, Part VI provides a roadmap for Congress in enacting a loophole-free federal usury cap.

II. THE LAW OF USURY IN THE U.S.

This Part describes the history of usury caps in the United States as well as the current law of usury in the United States.

A. HISTORY OF USURY IN THE U.S.

Until twenty-five years ago, most U.S. states had usury laws that capped interests on consumer loans.[9] In the U.S., usury laws have historically been the main protection consumers have had against harsh credit practices. Usury dates back to the earliest recorded civilizations and has a very prominent role in early American laws.[10] The first U.S. laws were borrowed from England's 5% Statute of Anne.[11] The English usury laws that this country inherited grew out of the moral view that charging more than 5% was wrong.[12] Similarly, in the 1400s and 1500s, Catholic and Protestant churches espoused rates of no higher than 8%.[13]

The first American usury law was adopted by Massachusetts in 1641, imposing an 8% per annum cap.[14] As Christopher Peterson explains:

> Early American usury laws were all written in clear terms, specifying a maximum simple nominal annual interest rate. These seminal American statutes were undiluted, trim, and perhaps even elegant in comparison to contemporary statutes that employ a variety of different types of interest rates and include a host of exceptions for various fees and different types of lenders.[15]

All thirteen of the original states adopted usury caps of between 5% and 8%, which remained in place until the late 1800s and early 1900s, when salary lenders found ways around these caps and began charging 500% or

---

9. *See* Christopher Peterson, *Usury Law, Payday Loans, Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1111 (2008).
10. *See id.* at 1113.
11. *See id.* at 1116.
12. *See id.* at 1116-17
13. *See id.* at 1117.
14. *See* Peterson, *supra* note 9, at 1117.
15. *Id.*

more.[16] Next, a social reformer named Arthur Ham, working with the well-funded Russell Sage Foundation, drafted a model statute that eliminated these practices and capped interest at 24-42% per annum.[17] The resulting small loan laws adopted by the states required all consumer lenders to obtain licenses from state governments in exchange for the ability to charge these higher rates.[18]

Salary lenders were ultimately pushed out by competition from traditional lenders,[19] but interest rate caps remained more or less in place throughout the United Sates until the Supreme Court's decision in *Marquette National Bank v. First Omaha Service Corp.*,[20] in which the Supreme Court was asked to decide which state's usury law applies when a national bank lends money to a consumer in another state—that of the consumer or that of the bank.[21] When the U.S. Supreme Court concluded that the bank's state rate applied, states began eliminating their usury caps in order to attract financial institutions to their states, with South Dakota and Delaware eliminating their caps first.[22] The decision effectively deregulated state interest rate caps by allowing national banks headquartered in a state without usury caps to export their lack of an interest rate cap on consumers in any state.[23] State lenders soon lobbied Congress for the same right, which Con-

---

16. *See id.* at 1118-19. Salary lenders were able to undermine usury caps by using confessions of judgment and profitable relationships with magistrate judges. *See id.* at 1119-20. *See also* Robert Mayer, *Loan Sharks, Interest-Rate Caps, and Deregulation*, 69 WASH. & LEE L. REV. 807, 810-12 (2012).

17. *See* Peterson, *supra* note 9, at 1120.

18. *See id.* at 1121.

19. *See id.* at 1120.

20. Marquette Nat'l Bank v. First Omaha Serv. Corp., 439 U.S. 299 (1978).

21. *See id.* at 309-13. *See also* Schmitz, *supra* note 6, at 92. As Professor Schmitz notes:

> The United States Supreme Court has interpreted the National Bank Act ("NBA") to allow national and state chartered banks and thrifts to "export" favorable laws from their home states in order to circumvent less-favorable laws in other states where they do business . . . [meaning] that a bank chartered in Delaware may impose its interest rates on consumers in Colorado without worry about Colorado usury rate laws. Payday lenders use this to their advantage by affiliating with banks in states allowing for higher rates, and banks have started payday loan subsidiaries. Internet and out-of-state payday lenders seek to use the dormant commerce clause to challenge states' imposition of regulations on those who lend to their citizens.

Id.

22. *See* Peterson, *supra* note 9, at 1122.

23. *See id.* at 1122.

gress granted.[24] Thereafter, banks at least, could charge customers whatever rate they liked.[25]

This led to feelings of unfairness by non-bank lenders who were stuck with interest rate caps. Personal finance companies and other small non-bank lenders eventually began their own fights against state usury caps, causing even more states to eliminate their interest rate caps.[26] Soon the old salary lenders reinvented themselves as payday lenders, a transformation process that continues to this day.[27]

Originally, because of Jacksonian Democrats' concern over the power of federal banks, usury has historically been the domain of states, not the federal government.[28] In enacting the National Bank Act of 1863, Congress explicitly allowed national banks to charge interest at the rates allowed by the state in which the bank was located.[29] At that time, however, lending was a strictly local business, and it made sense for usury to be a local issue as well. Today lending is a national, if not global, endeavor.

---

24. *See id.*
25. *See id.*
26. *See id.* at 1123.
27. *See* Peterson, *supra* note 9, at 1123.
28. *But see* Martin S. Tanner, Note, *Usury Implications of Alternative Mortgage Instruments: The Uncertainty in Calculating Permissive Returns*, 1986 BYU L. REV. 1105, 1105 (1986). As Tanner notes in footnote five, however, federal usury laws have been in effect in some form or another since the 1800s. *See id.* at 1106 n.5 (citing National Bank Act, ch. 106, 13 Stat. 108 (1864) (codified at 12 U.S.C. § 86 (1983))).
29. 12 U.S.C. § 85 (2013). While state legislatures are now effectively in charge of whether there is a usury cap on consumer loans in their states, Congress clearly has the power to enact a federal usury cap under the commerce clause of the Constitution. U.S. CONST. art. 1, § 8, cl. 3. Indeed, in 2007, it did just that in passing the Military Lending Act, which caps interest on all consumer loans made to the military at 36%. *See* Military Lending Act, Pub. L. No. 109-364, § 670(a), 120 Stat. 2083, 2266 (2006) (codified as amended at 10 U.S.C. § 987(b) (West, Westlaw current through P.L. 113-74)) (capping interest rates on certain payday loans, tax refund loans, and car title loans at 36%). As Part V explains, this law also has limitations, which Congress can avoid in future legislation. *See infra* notes 192-215 and accompanying text. The Military Lending Act was passed in response to research showing that high-cost lenders tend to congregate around military bases where people have low but regular paychecks. The proliferation of high-cost lenders among military personnel was seen as a threat to morale as well as national security. TOM FELTNER, JEAN ANN FOX & LAURA UDIS, CONSUMER FEDERATION OF AMERICA, POLICY BRIEF: GAPS IN THE MILITARY LENDING ACT LEAVE MANY SERVICE MEMBERS VULNERABLE TO ABUSIVE LENDING PRACTICES (2013), *available at* http://www.consumerfed.org/pdfs/130725-policybrief-mla-cfa.pdf. In enacting this Act, Congress relied on evidence that "[p]redatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force." DEP'T OF DEF., REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 53 (2006), *available at* http://www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf. In its report of the effectiveness of the Act, the Consumer Federation of America also found that lenders are finding ways around the Military Lending Act. FELTNER, FOX & UDIS, *supra* note 29, at 4.

B. THE CURRENT PATCHWORK OF LAWS ON INTEREST RATE CAPS

Lending is no longer a local affair. Nevertheless, there currently is no federal law regulating the specific terms of consumer loans, although the Truth in Lending Act,[30] the Electronic Fund Transfer Act,[31] and other general federal laws apply to online lending. Whether to have a usury cap is left to states and some states still cap interest on all consumer loans. For example, along most of the eastern seaboard, it is still common for the law to cap the amount of interest and fees a lender can charge for any type of consumer loan in a way that Professor Peterson describes as "undiluted and trim."[32] In other words, no lender can charge more than 18% or 36% for a loan of any kind, no exceptions. I will refer to those kinds of laws as those with "true caps."

In most of the country, however, true caps are rare indeed. More specifically, eighteen states plus the District of Columbia either forbid payday lending or cap interest rates in a fashion that makes lending undesirable.[33] The rest of the states have either no regulation of consumer loans, have regulations that affirmatively allow the high-cost products described above, or have piecemeal laws that apply to one or more of the various types of loans. The resulting legislative patchwork has kept legislatures and consumer protections organizations busy around the clock, but has not resulted in any overall decrease in high-cost loans or in interest rates on such loans. To the contrary, the high-cost lending industry is growing exponentially, faster than any other part of the consumer credit sector.[34]

---

30. Truth in Lending Act, 15 U.S.C. §§ 1601–1667f (2006).

31. Electronic Funds Transfer Act, 15 U.S.C. §§ 1693–1693r (2006).

32. Peterson, *supra* note 9, at 1111.

33. CFED, PROTECTIONS FROM PREDATORY SHORT-TERM LOANS (2012), *available at* http://cfed.org/assets/scorecard/2013/rg_PredatoryLending_2013.pdf. The states that ban or cap payday loans at 36% or less are Arizona, Arkansas, Colorado, Connecticut, District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. *Id. See also Payday Lending Statutes*, NAT'L CONF. OF ST. LEGISLATURES (Jan. 18, 2013), http://www.ncsl.org/issues-research/banking/payday-lending-state-statutes.aspx.

34. CTR. FOR FIN. SERVS. INNOVATION, UNITED STATES UNDERBANKED FINANCIAL SERVICES ARE A $78 BILLION MARKETPLACE THAT ENCOMPASSES CLOSE TO TWO-DOZEN PRODUCTS AND SERVICES PROVIDED TO OVER 68 MILLION CONSUMERS (2011), *available at* http://www.cfsinnovation.com/system/files/CFSI_2011_Underbanked_Market_Sizing_Study_November_2012.pdf. This is a newsletter for the Center for Financial Services Innovation (CFSI), which claims to be:

> [T]he nation's leading authority on financial services for underserved consumers. Through insights gained by producing original research; promoting cross-sector collaboration; advising organizations and companies by offering specialized con-

III. PAYDAY-STYLE LENDING AND PUBLIC OPINION

Parts of this Article were presented at a conference on a panel entitled "Aberrant Contracts."[35] The panel title raises the question of what exactly makes a contract aberrant. According to Merriam-Webster, aberrant means "straying from the right or normal way" or "deviating from the usual or natural type."[36] Reasonable minds could disagree quite vehemently about what is right or natural, but they should be able to agree on what is normal or usual. To determine what is normal or usual in the realm of consumer loans, it is helpful to look at examples of interest rates on various types of consumer loans, including high-cost loans, as well as at public opinion of the appropriateness of interest rate caps in the context of consumer loans. This section demonstrates that high-cost lending rates are not normal, particularly when considering interest rates on other credit products as well as public opinion on such caps.

A. TERMS OF VARIOUS TYPES OF CONSUMER LOANS

If the likely reader of this law review Article walked into a bank or credit union and asked for a small short-term loan, the person would likely pay an interest rate of 10-18%.[37] Money borrowed on a credit card might run the average reader of this Article similar charges, perhaps higher interest if the person's credit is scarred.[38] A loan from a traditional financial institution, like a bank or credit union, on an unencumbered auto might run

---

> sulting services; shaping public policy; and investing in non-profit organizations and start-ups, CFSI delivers a deeply interconnected suite of services benefiting underserved consumers.

Id. at 8. As a pro-payday and title loan industry group, its research is funded by Morgan Stanley. *Id. See also* Fahzy Abdul-Rahman, *Small-Dollar Predatory Lending and Bad Loans,* GUIDE G-260 (N.M. State Univ., Coll. of Agric., Consumer, and Envtl. Scis., La Cruces, N.M.),Nov. 2012, at 1, *available at* http://aces.nmsu.edu/pubs/_g/G260.pdf. Abdul-Rahman reports that between 1992 and 2000, the number of predatory lenders in New Mexico grew from one per 66,000 citizens to one for every 5,212 citizens. *Id.*

35. This Article was written in connection with the panel entitled *Aberrant Contracts*, held by the AALS Section on Commercial Law and Related Consumer Lawat the 2013 AALS Meeting in Washington, D.C.

36. *Aberrant Definition*, MERRIAM-WEBSTER DICTIONARY, http://www.merriam-webster.com/dictionary/aberrant (last visited Aug. 5, 2013).

37. *Interest Rates,* ECONOMIC RESEARCH FEDERAL RESERVE BANK OF ST. LOUIS, http://research.stlouisfed.org/fred2/categories/22 (last visited Aug. 8, 2013).

38. *Id.*

such a person anywhere from 5% for a good credit risk, up to 21% for a poor credit risk.[39]

There are many varieties of high-cost loans, with markedly different terms. One example is the so called "installment loan" created in order to skirt a state law requiring loans made for fourteen to thirty-five days to limit interest and fees to $15 per $100 borrowed for up to fourteen days per loan. Lenders making installment loans can avoid state payday loan laws by making loans with durations longer than thirty-five days. Longer loans fall outside the regulations and thus remain unregulated. In one such installment loan, a customer borrowed $100, to be repaid in twenty-six bi-weekly installments of $40.16 each, plus a final installment of $55.34.[40] In total, this borrower paid $1,099.71 on a $100 loan. The annual percentage rate on the loan was 1,147%.[41]

Another example is a true "payday" loan, so named because its original purpose was to help a customer survive a short-term cash flow crisis between the time of the loan and the customer's next payday.[42] In one common form of payday loan, a consumer borrows money at a rate of between $15 and $25 per $100 for a period of fourteen days or less.[43] In other words, if a consumer was paid four days ago but is already out of cash, she can go borrow, for example, $400 between now and her next payday (now

---

39. *Id.* High-cost loans like payday or title loans cost fifty to one hundred times those rates of interest. While one could argue that the borrowers that use these high-cost products cannot get a bank or credit union loan, this is not necessarily true. Interview with Marvin Ginn, Executive Director, Native Community Finance (Aug. 5, 2013) (on file with author) (indicating that some title loan and payday loans customers can obtain loans from traditional lenders). *See also* Transcript of Interview With Clinic Client Regarding Title Loan (April 30, 2011) (on file with author). In this case, a 300% title loan was given to a woman who suffered brain damage in an auto accident. The loan was ultimately taken over by a local credit union. Even if it were true, this fact may or may not justify these differences in interest rate costs. Nor do these differences even begin to answer the question of whether high-cost loans do more harm than good for their borrowers. Nor is that the point; here we are merely trying to determine the meaning of "normal" or "usual" in the context of consumer credit.

40. *See* New Mexico *ex rel.* King v. B & B Inv. Grp., No. D-01010CV-2009-01916 at 1-2 (1st Dist. N.M., Dec. 3, 2010) (on file with author). *See also* Felix Salmon, *Loan Sharking Datapoints of the Day,* REUTERS (Jan. 7, 2010), http://blogs.reuters.com/felix-salmon/2010/01/07/loan-sharking-datapoints-of-the-day/ (last visited Jan. 11, 2010).

41. This assumes the lender is not able to convince the borrower to re-borrow the principal before the loan is paid back. *See infra* Part III.A.

42. *See* Ronald Mann & James Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 857 (2007) (explaining the mechanics of a typical payday loan); Karen E. Francis, Note, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday Loan Industry*, 88 TEX. L. REV. 611, 611–12 (2010) (describing a payday loan transaction).

43. *See* Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 564 (2010) (giving an example of a typical payday loan).

ten days away). To get that $400 at the $15 per $100 rate she would need a checking account and would write a check, or authorize an automatic debit, for $460 post dated to her next payday.[44] When payday comes, she can either let the check or debit clear, assuming the unlikely event that she now has this money, or she can go in and pay another $60 to borrow the same $400 for the next two weeks. This loan carries an annual interest rate of 390% or more.

Still another example is the auto title loan, for which consumers do not need bank accounts.[45] Rather, borrowers simply need an unencumbered automobile to secure the loan. These loans carry a typical interest rate of 25% per month or 300% per annum. While title loans typically carry lower interest rates than payday loans, they tend to be larger loans, increasing the chances that they will be difficult to repay and will create debt traps.[46] They also subject borrowers to the possibility of losing their vehicles, a risk not encountered with the other forms of high-cost loans described here. As Part II.B above explained, some states limit the availability of triple-digit interest rate loans. Most, however, do not. Interest rates ranging from 300% per annum to over 1,000% per annum hardly appear normal in today's credit world, a supposition bolstered by public opinion, discussed below.

B. PUBLIC OPINION OF INTEREST RATES AND INTEREST RATE CAPS

In every study or survey in which the public has been asked to comment,[47] the American public overwhelmingly supports government imposi-

---

44. *Id.*

45. *See* Jim Hawkins, Kathryn Fritzdixon & Paige Marta Skiba, *Dude, Where's My Car Title: The Law, Behavior, and Economics of Title Lending Markets*, U. ILL. L. REV. (forthcoming 2014), *available at http://ssrn.com/abstract=2224247*; Nathalie Martin & Ozymandias Adams, *Grand Theft Auto Loans: Repossession and Demographic Realities in Title Lending*, 77 MO. L. REV. 41 (2012).

46. Notably, Professor Jim Hawkins has found that borrowers do not fully understand the costs of title loans. *See* Hawkins, *supra* note 45. The people he surveyed did not exhibit an understanding of the high relative cost of title loans compared to credit card debt. *Id.* Only 25.71% (n = 9) recognized that a title loan is a lot more expensive than credit card debt, while 17.14% (n = 6) thought a title loan is a lot less expensive than credit card debt. *Id.* 5.71% (n = 2) thought a title loan was a little less expensive than credit card debt, and 31.43% (n = 11) thought the two were about the same cost. *Id.* While this small sample of people may not be indicative of borrowers generally, it is disturbing how few people understood the relative cost of their title loan.

47. CONSUMER FIN. SERVS. ASS'N OF AM., PAYDAY LOANS AND THE BORROWERS EXPERIENCE (2013), *available at* http://cfsaa.com/Portals/0/Harris_Interactive/CFSA_HarrisPoll_ExecutiveSummary.pdf. While this industry study indicates that payday loan borrowers appreciate having the option of taking out a payday loan, it by no means suggests that borrowers appreciate the 500%

tion of interest rate caps on consumer loans. Nationally, a survey by the Center for Responsible Lending shows that three out of four Americans who expressed an opinion think that Congress should cap interest rates, and 72% felt that the caps should be no higher than 36%.[48]

State ballot initiatives glean the same results. For example, in Montana, 72% of the population supported a ballot initiative that ultimately resulted in a 36% cap on interest rates for all loans in Montana.[49] Citizens of Kentucky also voted for a ballot initiative that ultimately capped all loans at 36%.[50] Similarly, Arizonans overwhelmingly supported a ballot initiative

---

interest rates. My recent study suggests that people who have taken out payday loans are more likely to believe in interest rate caps than those that have not. *See generally* Goldsmith & Martin, *supra* note 4.

48. CTR. FOR RESPONSIBLE LENDING, CONGRESS SHOULD CAP INTEREST RATES: SURVEY CONFIRMS PUBLIC SUPPORT FOR CRACKING DOWN ON HIGH-COST LENDING (2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf; Christopher L. Peterson, *'Warning: Predatory Lender' - A Proposal for Candid Predatory Small Loan Ordinances*, 69 WASH. & LEE L. REV. 893, 893 (2012), *available at* http://ssrn.com/abstract=1971971 stating that:

> 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.

Id. n.1 (citing CTR. FOR POLICY ENTREPRENEURSHIP, POLL ON PAYDAY LENDING LEGISLATION (Feb. 15, 2008), *available at* http://www.c-pe.org/download/PaydayLendingReform/PollPaydayLending.pdf) (stating that a 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").

49. LAKE RESEARCH PARTNERS, RESULTS OF A STATEWIDE SURVEY ON A MONTANA BALLOT INITIATIVE TO CAP INTEREST RATES OF PREDATORY LENDERS (Jan. 2010), *available at* http://www.consumerfed.org/pdfs/Publicmemo-MT-Payday.pdf; *Payday Lenders Less Popular than Liquor Stores, Majority of Voters Would Support Moratorium, According to San Jose Poll*, CENTER FOR RESPONSIBLE LENDING (Feb. 3, 2011), http://www.responsiblelending.org/media-center/press-releases/archives/Payday-lenders-less-popular-than-liquor-stores-majority-of-voters-would-support-moratorium-according-to-San-Jos%C3%A9-poll.html#; *Poll Shows Support For Capping Payday Loan Rates And Fees*, THE VINDICATOR (Jan. 25, 2013, 11:25 AM), http://www.thevindicator.com/news/article_2d0406f0-6714-11e2-997e-0019bb2963f4.html; *Montana Loan Interest Rate Limit, I-64 (2010)*, BALLOTPEDIA (Jul. 6, 2012, 11:54 AM), http://ballotpedia.org/wiki/index.php/Montana_Loan_Interest_Rate_Limit,_I-164_(2010) (reporting that nearly 72% of Montana voters voted to cap interest rates on payday and auto title loans at 36% APR); *Ohio Payday Lender Interest Rate Cap, Issue 5 (2008)*, BALLOTPEDIA (Aug. 8, 2013, 12:03 PM), http://ballotpedia.org/Ohio_Payday_Lender_Interest_Rate_Cap,_Issue_5_(2008).

50. KY. COAL. FOR RESPONSIBLE LENDING, KENTUCKY VOTERS SUPPORT A 36 PERCENT RATE CAP ON PAYDAY LOANS, DESPITE DATABASE AND JOB LOSS THREATS, *available at* http://kyresponsiblelending.org/wp-content/uploads/2012/10/Poll-data-fact-sheet.pdf.

that ended payday lending in the state.[51] Additionally, in 2008, 68% of Ohioans support a ballot initiative that capped interest in the state at 28%.[52]

Public opinion survey data shows similar public proclivities in favor of interest rate caps. After hearing that payday and title lenders can charge 500% or more in Texas, 63% of Texans age forty-five or older strongly agreed that the state should cap interest rates and fees, with 77% of respondents reporting that the cap should be 36% or less.[53] In another survey taken by the Texas Fair Lending Alliance,[54] and the Texas Faith for Fair Lending, 85% of people polled favored capping interest rates on payday and auto title loans at 36% APR or less.[55] In Iowa, survey data show that

---

51. *Arizona Payday Loan Reform, Proposition 200 (2008)*, BALLOTPEDIA (Dec. 3, 2013, 2:35 PM), http://ballotpedia.org/wiki/index.php/Arizona_Payday_Loan_Reform,_Proposition_200_(2008) (reporting that voters in Arizona defeated a payday sponsored ballot initiative, mandating an end to state statutes that allow 400% interest rates). *Montana Loan Interest Rate Limit*, supra note 49. Arizona still allows title loans, however, which now proliferate throughout the state. Maureen West, *Payday Lenders Morphing into Auto Title Lenders: Loophole Allows Interest Rates Up to 204 Percent,* AARP BULL. (Dec. 1, 2010), http://www.aarp.org/money/scams-fraud/info-12-2010/payday_lenders_morphing_into_auto_title_lenders.html.

52. *Coalition, Raimondo, Taveras Raise Awareness on Payday Lending Pitfalls*, RI.GOV (Apr. 17, 2012), http://www.ri.gov/press/view/16334 (reporting that 76% of Rhode Islanders polled support capping payday loan interest rates); *Ohio Payday Lender Interest Rate Cap, Issue 5 (2008)*, BALLOTPEDIA (Aug. 8, 2013, 12:03 PM), http://ballotpedia.org/wiki/index.php/Ohio_Payday_Lender_Interest_Rate_Cap,_Issue_5_(2008) (reporting that over 63% of Ohio voters voted in favor of capping the Ohio payday loan industry's interest rate at 28%).

53. JENNIFER H. SAUER, AARP, SUMMARY OF AARP POLL OF TEXANS AGE 45+: OPINIONS ON PAYDAY LOAN RATES AND LEGISLATION (Jan. 2013), *available at* http://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2013/Summary-of-AARP-Poll-of-Texans-Age-45-Plus-Opinions-on-Payday-Loan-Rates-and-Legislation-AARP.pdf ; LBJ SCH. OF PUB. AFFAIRS, CTR. FOR POLITICS AND GOVERNANCE, PAYDAY AND AUTO TITLE LENDING, *available at* http://www.utexas.edu/lbj/cpg/docs/f3_2013_payday.pdf; (summarizing existing Texas law).

54. The Texas Fair Lending Alliance is a Texas coalition comprised of almost sixty financial, community, and faith organizations dedicated to bringing increased regulation to the payday loan industry. *TFLA,* TEX. FAIR LENDING ALLIANCE, http://www.texasfairlending.org/tfla/ (last visited Feb. 6, 2014).

55. Rudolph Bush, *Statewide Survey Shows Broad Support for Payday Lending Reform*, DALLASNEWS.COM (June 21, 2012), http://cityhallblog.dallasnews.com/2012/06/statewide-survey-shows-broad-support-for-payday-lending-reform.html/ (reporting that 85% of Texans polled favored capping interest rates on payday and auto title loans at 36% APR or less); *Poll Shows Support for Capping Payday Loan Rates and Fees*, THE VINDICATOR, (Jan. 25, 2013), http://www.thevindicator.com/news/article_2d0406f0-6714-11e2-997e-0019bb2963f4.html.

seven in ten Iowans believe payday loan rates and fees should be capped.[56] In Rhode Island, the only state in New England to allow storefront payday lending, a public opinion poll showed that 62% of Rhode Islanders supported capping interest on payday loans.[57] Finally, a public poll of Coloradans showed that 74% of Coloradans support a similar 36% cap.[58]

Additionally, support for caps crosses party lines.[59] In a recent study I conducted with Professor Tim Goldsmith, we set out to measure not just overall support for interest rate caps but political affiliation of those who favor caps on consumer loans. Our data show widespread support for interest rate caps across political lines. We did find that more Democrats favor interest rate caps than Republicans, with 94% of Democrats favoring caps and 73% of Republicans favoring caps. What is remarkable, however, is just how many very conservative people favor caps. Our data show that over 57% of people who report being "very conservative" politically and over 82% of those who report being "conservative" politically favor interest rate caps over no interest rate caps.[60]

While wondering aloud why the public is not more active in seeking out laws that cap interest, we stumbled upon a possible explanation. First, many people incorrectly think interest rates are capped (over 58% for credit cards and over 43% for short-term loans), when in reality these rates are not capped.[61] In other words, people misunderstand and overestimate the protection the law currently provides. Second, even among those who know that the law provides *no* caps, most are unaware that lenders in the state in which the study was conducted currently charge interest rates of 200% or

---

56. *Iowans for Payday Loan Reform: Iowa Poll Reveals Strong Bi-partisan Support for Payday Lending Reform,* IOWAPOLITICS.COM (Jan. 26, 2011) (on file with author) (reporting that 7 in 10 Iowans called for capped payday loan interest rates).

57. *Coalition, Raimondo, Taveras Raise Awareness on Payday Lending Pitfalls, supra* note 52 (reporting that 76% of Rhode Islanders polled support capping payday loan interest rates); CATHOLIC CONFERENCE OF OHIO, 2010 PAYDAY LENDING POLL RESULTS (April 29, 2010), http://www.ohiocathconf.org/i/EJ/GraphWork04.pdf.

58. *Poll on Payday Lending Legislation*, CENTER FOR POLICY ENTREPRENEURSHIP (Feb. 15, 2008) (stating that a 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"). A survey of 400 consumers conducted and completed in San Jose California showed 63% of voters favored a moratorium on new payday loan stores. *Payday Lenders Less Popular than Liquor Stores, Majority of Voters Would Support Moratorium, According to San Jose Poll*, CENTER FOR RESPONSIBLE LENDING, http://www.responsiblelending.org/media-center/press-releases/archives/Payday-lenders-less-popular-than-liquor-stores-majority-of-voters-would-support-moratorium-according-to-San-Jos%C3%A9-poll.html# (last visited Feb. 5, 2014).

59. Goldsmith & Martin, *supra* note 4, at 128-29. Overall, over 94% of Democrats favored interest rate caps, over 73% of Republicans favored caps, and almost 90% of Independents favored caps. *Id.*

60. *Id.* at 129.

61. *Id.* at 124-26.

more. Indeed, we found that 81% of the public was unaware of the costs of these loans.[62] These poll data support the notion that 300% to 1,000% loans are not normal or usual.

IV. STATE LAW AND HIGH INTEREST CREDIT: A WASTELAND OF INEFFICIENCY

Despite wide and deep public support for rate caps,[63] uniform interest rate caps that apply to all consumer loan products are few and far between. Moreover, those caps that do exist are often ineffective due to state laws' inability to regulate certain lenders, namely those lenders located offshore or affiliated with Indian tribes, which provide on-line loans.

In states where diluted and incomprehensibly complex statutes are passed to limit high-interest lending, even storefront lenders find ways around those laws by changing the attributes of the loans to avoid the laws, fitting within exceptions created by other laws on the books, or becoming credit service organizations ("CSOs"), which are exempt from the laws. This complex game of whack-a-mole makes regulating state by state an expensive yet ineffective endeavor.

Unfortunately, using the court system to enforce even the trim and undiluted laws is similarly ineffective and inefficient. In states with true caps, lenders sometimes ignore the caps. This forces consumers and cash-strapped states that wish to hold lenders to the law to use valuable resources to sue the lenders. Additionally, fighting high-interest lenders who violate the law in court is inefficient because courts are not in agreement about whether existing judicial remedies, such as unconscionability, even apply to a product that has not been outlawed by a state legislature. Finally, even when courts do find high-cost loans unconscionable, the lender can still rely on broad anti-class action and arbitration clauses to avoid liability, and if all else fails, file for bankruptcy, thus prolonging the availability of loans that violate state laws. All of this demonstrates how the current legislative and

---

62. *Id.* at 128.

63. *See supra* notes 49-62 and accompanying text. While consumers generally support caps, it is unclear whether such caps would affect supply of loans and if so, if customers would still support caps if they thought caps might dry up lending for people with poor credit. In recent Pew Charitable Trust studies, payday loan borrowers reported preference for increased transparency and education rather than loan preclusions. *See* THE PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: HOW BORROWERS CHOOSE AND REPAY PAYDAY LOANS 43-45 (2013), which follows up on THE PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: WHO BORROWS, WHERE THEY BORROW, AND WHY (2012). However, 72% also reported that legal reform was necessary. *See id.* at 45. Moreover, in our study, Tim Goldsmith and I found that people who had taken out payday loans were more likely than those who had not to support caps on interest rates. *See* Goldsmith & Martin, *supra* note 4, at 130.

judicial landscape is inadequate to meet the public's expectations about how government should regulate.

A. LEGISLATIVE WASTE

1. One Form of Loophole: The Long Legislative Battle to Enact a Law of No Consequence

Loopholes happen. In the world of payday lending, they happen a lot. For example, payday lenders began appearing in New Mexico after the state repealed its General Usury statute (former NMSA 1978 §56-8-11-1) in 1991.[64] For five very long and frustrating years, the New Mexico Legislature debated various payday lending statutes. Finally, during the legislative session of 2007, the Legislature adopted a set of changes to the New Mexico Small Loan Act of 1955 intended to restrict payday lending in New Mexico.[65] These regulations went into effect in July 2007. The New Mexico law is similar to those of several other states in that the regulations rely on a computer database enforcement mechanism for consumer qualification and reporting.[66] In fact, thirty-three states have laws that bear some similarity to this new New Mexico law. [67] Yet none of these laws curb payday lending, despite legislative goals of curbing high-cost loan abuses.

The new law capped interest and fees at $15 per $100 for each period of fourteen days or less. When taken as an annual percentage rate, calculated by multiplying this rate by twenty-six two-week periods over the course of a year, these terms result in an interest rate of 390% per annum or higher. The new law also applied only to lenders engaged in the business of lending amounts of $2,500.00 or less[68] and defined a loan covered by the Act as one of fourteen to thirty-five days in duration, for which the consumer gives the lender a check or debit authorization for the amount of the loan plus interest and fees. In the end, this narrow definition gutted the legislation. The industry quickly switched to loan products that fall outside the statute, namely

64. *See* Goldsmith & Martin, *supra* note 4, at 578.

65. N.M. STAT. ANN. §§ 58-15-1 to -39 (West 2010).

66. Other states that have enacted similar statutes and use the same database enforcement mechanisms include Florida, Oklahoma, Indiana, Illinois, Michigan, and North Dakota. For a list of state statutes, see Goldsmith & Martin, *supra* note 4, at 578 n.77.

67. *See id.* at 578 n.78.

68. N.M. STAT. ANN. § 58-15-3(A) (1978). These lenders are required to obtain a license from the New Mexico Financial Institutions Division (FID) and to comply with all aspects of the Act. However, state level licensing entities (or their authorizing statutes) do not actually regulate high cost lending. Most readers and the public might assume that a state regulator would take action to curb harmful practices, but pay-day lenders have had to be licensed for thirty years in New Mexico and there has been no action by these entities to prevent abuse.

longer loans or those not involving a post-dated check. This was done so that lenders could charge more than 390% per annum. Naturally, these loans that fall outside the definition are not regulated at all. Thus, the state of New Mexico spent several years attempting to regulate payday lending, but the resulting law has done nothing to change short-term lending at high interest rates.[69]

Ineffective laws, like the New Mexico statute, have been passed in various other states around the country. For example, Professor Robert Mayer reports on a similar legislative process in Illinois:

> Regulators in Illinois imposed rules in 2001 that were designed to [curb the number of payday loans and roll-overs]. Customers were allowed to borrow no more than $400; only two renewals were permitted, with some of the principal paid down each time; and a cooling-off period was mandated to prevent borrowers from using the proceeds of a new loan to pay off the old one. The state . . . promised to establish a database to track loan activity and enforce the rules.[70]

As in New Mexico, Illinois payday lenders quickly devised a new product to evade the rules. The statute applied to cash advances with a term of less than thirty-one days, so the industry created a thirty-one-day loan not covered by the rules.[71] As a result, all of the old abuses persist.[72] A 2003

---

69. *New Mexico ex rel*. King v. B & B Inv. Grp., No. D-01010CV-2009-01916 at 8 (1st Dist. N.M., Dec. 3, 2010) (on file with author). Moreover, the industry knew it would not. Here is what the industry itself says about various legislative efforts, such as those in South Carolina:

> We have no complaint that after long debate, the Senate and House agreed on a bill to limit borrowers to one payday loan at a time, a cap of $550, a cooling off period and the ability of payday loan providers to electronically debit their customer's bank account. The implementation of a state-wide data base is of little consequence as well.

Id. The non-interest rate aspects of payday lending legislation have also failed to curb the industry or prevent consumers from getting caught in debt traps. For example, the New Mexico law provided for an interest-free payment plan as well. Goldsmith & Martin, *supra* note 4, at 580-81. While in brief compliance with the law, some lenders tried to get around the interest-free installment plan by telling borrowers that if they used this feature, they would be denied future payday loans. *Id.*

70. Robert Mayer, *One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County* 8 (Loyola Univ. Chi. Political Sci. Dep't, Working Paper), *available at* http://www.luc.edu/faculty/rmayer/mayer21.pdf (last accessed Aug. 6, 2009).

71. *Id.*

72. *Id.*

Illinois Division of Financial Institutions report acknowledged that it remains "quite common for borrowers to have multiple payday loans outstanding with several different payday loan companies."[73] Similar end runs occurred in Oklahoma. Additionally, other states such as Florida, Illinois, and Michigan have tried to impose interest-free payment plans like that proposed in New Mexico, but these laws have produced no meaningful reduction in the number of trapped borrowers.

2. Using Exceptions Created by Other Laws to Get Around Usury

Other forms of loopholes also abound. In 2008, the Ohio State Legislature voted to rescind a twelve-year-old law that exempted payday lenders from the state's usury laws, a vote Ohioans supported two to one.[74] An existing short-term loan law purported to cap interest on all short-term loans at 28% and also to give customers at least a month to pay off the loans.[75] In response, lenders simply switched their licenses so they could offer payday loan look-alikes under two parallel lending statutes, the Small Loan Act or the Mortgage Lending Act.[76] Making these changes was simple for lenders, and they began offering even higher cost loans, as this industry web site explains:

> By adjusting the loan amount to just above $500, payday loan lenders double the loan origination fees from $15 to $30. The Small Loan and Mortgage Lending acts allow the fees on top of the 28 percent interest, something the new payday lending law doesn't permit. Under the new HB 545 licensing scheme with the check cashing fees added, customers pay the same $575 to walk out the door with $500 in cash . . . .
>
> A First American payday loan customer indicated he previously paid $75 for a $500 loan, First American charged him a total of $90 to borrow the same amount after the law changed. More than one Ohio payday loan company has structured their check

---

73. Feltner, T., & Williams, M. 2004. "New Terms for Payday Loans: High Cost Lenders Change Loan Terms to Evade Illinois Consumer Protections." Woodstock Institute: Reinvestment Alert. #26, *quoted in* Mayer, *supra* note 70 at 8.

74. *Ohio Payday Lender Interest Rate Cap, Issue 5 (2008)*, BALLOTPEDIA (Aug. 8, 2013, 12:03 PM), http://ballotpedia.org/wiki/index.php/Ohio_Payday_Loan_Referendum_(2008).

75. OHIO REV. CODE ANN. § 1321.40 (West 2004) (effective Sept. 1, 2008).

76. Goldsmith & Martin, *supra* note 4, at 591 n.151.

> cashing and loan operations as two separate entities to justify the fees.[77]

Then Ohio Attorney General Rich Cordray said his office has found payday loans with APR's ranging from 128% to 700% immediately after the ballot initiative that purported to cap interest on consumer loans in Ohio at 28%.[78]

3. *Credit Service Organizations and Payday Loans*

Another loophole is the credit service organization (CSO). Congress and numerous states have enacted CSO legislation in an effort to crack down on abuses by companies claiming they could help individuals repair their credit.[79] These agencies were charging large fees in exchange for purportedly helping consumers clean up poor credit histories and gain access to more credit. Most of the services provided turned out to be scams, and some agencies even offered to allow people to rent other people's credit scores for fees of $2,000 or more. To curb these abuses, states enacted laws prohibiting agencies from charging fees for these types of services, and thereafter, Congress enacted the Credit Repair Organization Act.[80]

---

77. *Id.* As another industry web page explains:

> With news of the passage of Issue 5 in Ohio on Nov. 4, Check Into Cash began restructuring its loan product offerings throughout the Buckeye state to comply with the new law. On Nov. 5, the company ceased to offer payday loans and began offering a new product, micro loans, which are short-term loans from $50 to $600 and permitted under Ohio's Small Loan Act.
>
> These new micro loans are one way that Check Into Cash is striving to continue to serve its valued customers with the same level of service as it has in prior years. Even though this new Ohio legislation was designed to make it difficult to continue serving customers who desire payday advance services, Check Into Cash has pushed ahead, endeavoring to persevere with its ongoing commitment to customer service.

Check Into Cash Committed to Serving Ohio Customers, PRWEB (Nov. 18, 2008, 10:19 AM), http://www.prweb.com/releases/checkintocash/ohio/prweb1628414.htm, *quoted in* Goldsmith & Martin, *supra* note 4, at 591 n.151.

78. Sheryl Harris, *Payday Lenders Find Legal Loophole That Lets Them Continue High-Interest Loans*, THE PLAIN DEALER (Feb. 16, 2009, 3:18 AM), http://www.cleveland.com/consumeraffairs/index.ssf/2009/02/payday_loans_are_back_in_a_new.html.

79. *See* Goldsmith & Martin, *supra* note 4, at 592-94.

80. CAL. CIV. CODE § 1789.12(a)(1)-(3) (West 2008).

The definition of CSO in a CSO statute is typically broad,[81] allowing payday lenders to redefine themselves as CSOs.[82] Many lenders did just that, meaning that rather than morphing their loan products into another form to avoid state laws, they transformed themselves into CSOs in order to continue providing the same loans or even more expensive ones.[83] CSO statutes do not cap interest rates or fees, leaving the door open for payday lenders to slip into the definition of a CSO and go back to business as usual.[84] Thirty-eight states have state CSO statutes, many of which are used regularly to evade other state laws. [85] CSOs are incredibly prolific in Texas, as well as in Michigan and Florida.[86]

4. *Online Lending*

Internet payday lending is growing quickly and online lenders typically claim to be immune from state laws. Even where states have won cases holding that online lenders must comply with state laws, lenders often fail

---

81. Most of these statutes define a CSO as:

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

Id.

82. *See* Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 962 (2008).

83. Here is how one payday loan web site describes the CSO loophole:

> If you're not familiar with the CSO payday loan model it essentially consists of a "servicer" that markets the product, services the product, and accepts the risks associated with the product by issuing a "letter of credit" on behalf of the "borrower" to a "lender". A Credit Services Organization typically charges the consumer $20 - $30 per $100 loaned for 7 to 31 days. The CSO Credit Services Organization is "registered" with the state rather than "licensed" by the state. The state does not "regulate" the CSO.

Florida Payday Loan Credit Services Organization Issues, PAYDAY LOAN INDUSTRY BLOG (June 17, 2008), http://paydayloanindustryblog.com/florida-payday-loan-credit-services-organization-issues.

84. Spector, *supra* note 82, at 988.

85. *See* Goldsmith & Martin *supra* note 4, at 592 n.154.

86. *See Id.* at 594-95.

to do so.[87] State regulators have again garnered precious resources to enforce their laws, often to no avail. For example, Colorado and West Virginia have been particularly active at fighting online attempts to skirt state laws.[88] The most recent survey by the Consumer Federation of America (CFA) notes that lenders continue to claim choice of law from lax jurisdictions, to locate offshore, or to claim tribal sovereign immunity to avoid complying with state consumer protections.[89]

The tribal sovereign immunity loophole is particularly damaging, as it pits two traditionally disadvantaged groups, Native Americans and low-income consumers, against one another in a complex battle over who needs protection more.[90] Under this model, lenders team up with Indian tribes to avoid state laws. Tribes engaged in off-reservation activities must comply with non-discriminatory state laws, as must anybody else.[91] Despite this requirement, tribes are immune from suit because they are separate sover-

---

87. *See* JEAN ANN FOX & ANNA PETRINI, CONSUMER FED'N OF AM., INTERNET PAYDAY LENDING: HOW HIGH-PRICED LENDERS USE THE INTERNET TO MIRE BORROWERS IN DEBT AND EVADE STATE CONSUMER PROTECTIONS 7-12, 22 (2004), *available at* http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Internet_Payday_Lending113004.PDF (discussing the costs of internet payday loans).

88. *See* Press Release, West Virginia Attorney General's Office (Aug. 24, 2012) (on file with author); Nathalie Martin & Joshua Schwatrz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?* 69 WASH. & LEE L. REV. 751, 779-80 (2012) (describing a case brought against alleged tribal lenders by the Colorado Attorney General's Office); Heather L. Petrovich, *Circumventing State Consumer Protection Laws: Tribal Sovereign Immunity and Internet Payday Lending,* 91 N.C. L. REV. 326, 342 (2012). Colorado regulators are also very active. *See Attorney General Announces 2011 Annual Lending Data Report*, COLO. DEP'T OF L. (Oct. 10, 2012), http://www.coloradoattorneygeneral.gov/press/news/2012/10/01/attorney_general_announces_2011_annual_lending_data_report. The Attorney General also has issued press releases announcing settlements involving online payday lending. *See, e.g.*, Press Release, Colo. Dep't of Law, Attorney General Suthers Announces $2 Million Settlement with Internet "Payday" Lender (Dec. 23, 2005), *available at* http://www.coloradoattorneygeneral.gov/press/news/2005/12/23/attorney_general_suthers_announces_2_million_settlement_internet_%E2%80%9Cpayday%E2%80%9D_lend and http://www.coloradoattorneygeneral.gov/press/news/2008/03/13/attorney_general_suthers_announces_payday_lending_settlement. *See also* Colorado v. W. Sky Fin., L.L.C., 845 F. Supp. 2d 1178 (D. Colo. 2011).

89. *See* FOX & PETRINI, *supra* note 87, at 4. While it is true that even federal laws do not necessarily stop offshore lenders, the federal government has more enforcement power so a federal interest rate cap could make it easier to regulate offshore entities.

90. *See, e.g.*, Bree R. Black Horse, *The Risks and Benefits of Tribal Payday Lending to Tribal Sovereign Immunity*, 1 AM. INDIAN L. J. 388 (2013); Adam Mayle, Note, *Usury on the Reservation*, 31 REV. OF BANKING AND FIN. L. 1054 (2012); Martin & Schwartz, *supra* note 88; Heather L. Petrovich, Comment, *Circumventing State Consumer Protection Laws: Tribal Immunity and Internet Payday Lending*, 91 N.C. L. REV. 326 (2012).

91. Colorado *ex rel.* Suthers v. Cash Advance, 205 P.3d 389 (Colo. App. 2008), *aff'd*, 242 P.3d 1099 (Colo. 2010).

eigns.[92] Thus, while they must obey state laws, they cannot be sued to enforce the laws or compel their compliance. This motivates lenders to seek out tribal partners, as this industry web site explains:

> Due to the strict regulations that are hitting the payday loan industry hard, many lenders are now turning to Indian Tribes to help them out. The American Indian Tribes throughout the United States have been granted sovereign immunity which means that they are not held subject to the laws that payday loans are currently going up against. There are 12 states which have banned payday lending but as long as their [sic] is an Indian tribe who runs the operation on this sovereign land, the lenders can continue their business even where payday loans have already been banned. Similar to the Casino boom, payday loans are the new financial strategy that many are using as a loophole through the strict payday loan laws. The revenue is quite high and promising for these tribes who often find themselves struggling. There are approximately 35 online cash advance and payday loan companies that are owned by American Indian tribes. Consumers have taken out approximately 12,500 loans over the last year in which these tribes made approximately $420 million. It is no surprise that many lending companies are currently seeking out American Indian Tribes in an effort to save their businesses by escaping US lending laws. Tribal leaders are paid a few thousand dollars a month for allowing a payday lender to incorporate on tribal land. The more lenders that tribes allow to move onto their reservation, the larger the profit that they make.[93]

Often, as this excerpt clearly articulates, the lenders using this model are not tribes. Proving that the lenders are not entitled to tribal sovereign immunity is not easy, however. A trim federal interest rate cap would eliminate this loophole, as even tribes are bound by federal law.

---

92. *Id.*
93. *The Connection Between Indian Tribes and Payday Lending*, ONLINE CASH ADVANCE (on file with the author).

5. *Colorado: An Example of a State Consumer Lending Law That Works, but at What Cost?*

Despite all of the failures described above, states can sometimes curb high-cost loan abuses. Doing so, however, is costly and takes deep dedication. As an example of a state law that has worked at least to some extent, Colorado passed a state law in 2010 that has drastically reduced the number of payday loans in the state as well as the interest rates on existing payday loans.[94] The law sets a maximum loan amount at $500 and adds provisions designed to keep consumers from getting trapped in the usual payday loan rollover cycle.[95] Consumers also have the right to cancel a payday loan transaction by 5:00 p.m. the following day.[96] Consumers may also choose to repay loans in one sum or pay the full amount over six months.[97] The law also caps interest rates for these loans at 45%,[98] but this rate limit does not include fees and other costs, which add significantly to the actual cost of the loans.[99]

A recent study completed by the Pew Charitable Trust concludes that this new law has been effective in reducing rates on payday loans.[100] Indeed, the dollar amounts of payday loans in Colorado have fallen almost 60%, and the number of loans fell from 1,110,224 loans in 2010 to 444,333 in 2011 after the law was implemented.[101] Data from the Colorado Attorney General's office indicate that the new law appears to have dropped average effective APRs from 338.90% to 191.54%.[102] In addition, quite significant-

---

94. COLO. REV. STAT. §§ 5-3.1-101 to 5-3.1-123 (2010).
95. *Id.* § 5-1.3-106(2).
96. *See* Schmitz, *supra* note 6, at 98 (citing COLO. REV. STAT. § 5-1.3-106(2)).
97. COLO. REV. STAT. §§ 5-3.1-101-106.
98. *Id.* § 5-3.1-105.
99. *See* Schmitz, *supra* note 6, at 98. *See also* David Callahan, *Pew's Appalling Thumbs Up for Payday Loans With 129% Annual Interest*, POLICYSHOP (Oct. 31, 2013), http://www.demos.org/blog/10/31/13/pews-appalling-thumbs-payday-loans-129-annual-interest.
100. THE PEW CHARITABLE TRUSTS, PAYDAY LENDING IN AMERICA: POLICY SOLUTIONS, REPORT 3 12-13 (2013), *available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2013/Pew_Payday_Policy_Solutions_Oct_2013.pdf.
101. *See* Press Release, Colo. Dep't of Law, Attorney General Announces 2011 Annual Lending Data Report (Oct. 1, 2012), *available at* http://www.coloradoattorneygeneral.gov/press/news/2012/10/01/attorney_general_announces_2011_annual_lending_data_report (last visited June 9, 2013), *cited in* Schmitz, *supra* note 6, at 99.
102. ADM'R OF THE COLO. UNIF. CONSUMER CREDIT CODE, COLORADO PAYDAY LENDING DEMOGRAPHICS AND STATISTICAL INFORMATION: JULY 2000 THROUGH DECEMBER 2011 (2012), *available at* http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/De

ly, the average number of payday loans consumers have taken out per year has fallen from 8.53 loans per person to 2.3 loans per person.[103]

Nonetheless, the average contract finance charge has risen significantly, from $60 to $237,[104] and some commentators are appalled at the fact that when fees and costs are included, the Colorado law allows interest rates of up to 129%.[105] There also has been an increase in "same-day-as-payoff" transactions, meaning the lender makes a new loan to a consumer on the same day the consumer pays their previous loan in full.[106] This allows the lender to easily get around attempts to limit rollovers. In summary, Colorado has been more vigilant than any other state in working on a solution to the payday lending problem, other than an interest rate cap. The law it passed, while better than what many other states have come up with, still has many problems. Moreover, few states have the will or the resources to go to the efforts to which Colorado has, making a federal solution to the problem efficient and effective by comparison. Congress has regularly and effectively taken over areas of consumer and commercial law[107] and should do so here as well.

B. JUDICIAL WASTE

One possible solution to the persistence of high-cost loans is to attempt to use courts to invalidate the loans. I purposely use the word "attempt" because, once again, the loans and their makers seem impervious to effective state regulation. Some of the limitations of these judicial efforts are outlined below.

---

mo%20%26%20Stat%20Info%202000-2011.pdf [hereinafter 2011 CO REPORT], *quoted in* Schmitz, *supra* note 6, at 99.

103. *Id.*; Attorney General Announces 2011 Annual Lending Data Report, *supra* note 101.

104. Attorney General Announces 2011 Annual Lending Data Report, *supra* note 101.

105. David Callahan, *Pew's Appalling Thumbs Up for Payday Loans With 129% Annual Interest,* POLICYSHOP (Oct. 31, 2013), http://www.demos.org/blog/10/31/13/pews-appalling-thumbs-payday-loans-129-annual-interest.

106. Schmitz, *supra* note 6, at 99.

107. *See, e.g.*, Bankruptcy Code, 11 U.S.C. §§ 101-1532 (2012); Truth in Lending Act, 15 U.S.C. §§ 1601-1667f (2012); Electronic Funds Transfer Act, 15 U.S.C. §§ 1693-1693r (2012).

1. High Cost Loans and Common Law Doctrine of Unconscionability

One possibility is to ask courts to use the common law doctrine of unconscionability to invalidate high-cost loans.[108] The doctrine of unconscionability gives courts the inherent power to decline to enforce a contract that is one sided or unfair to one party, either in whole or in part.[109] Courts can use the doctrine to strike down specific contract terms or entire contracts if the contracts or specific terms shock the conscience and are the product of a flawed bargaining procedure.[110]

---

108. The topic is popular with scholars if not useful to courts and consumers. *See generally* Amy J. Schmitz, *Embracing Unconcionability's Safety Net Function,* 58 ALA. L. REV. 73 (2006); Richard L. Barnes, *Rediscovering Subjectivity in Contracts: Adhesion and Unconscionability*, 66 LA. L. REV. 123 (2005-2006); Horacio Spector*, A Contractarian Approach to Unconscionabilty*, 81 CHI.-KENT L. REV. 95 (2006); Philip Bridwell*, The Philosophical Dimensions of the Doctrine of Unconscionability*, 70 U. CHI. L. REV. 1513 (2003); Mark Klock, *Unconscionability and Price Discrimination*, 69 TENN. L. REV. (2001-2002); Frank P. Darr, *Unconscionability and Price Fairness*, 20 HOUS. L. REV. 1819 (1993-1994); Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard*, 31 HOUS. L. REV. 721 (1994-1995); Jeffery C. Fort, *Understanding Unconscionability: Defining the Principle*, 9 LOY. U. CHI. L.J. 765 (1977-1978); Aaron-Andrew P. Bruhl, *The Unconscionability Game: Strategic Judging and the Evolution of Federal Arbitration Law*, 83 N.Y.U. L. REV. 1420 (2008); Larry A. DiMatteo & Bruce Louis Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067 (2005-2006); Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 224 J. LEGAL STUD. 283 (1995); Arthur Allen Leff, *Unconscionability and the Crowd—Consumers and the Common Law Tradition*, 31 U. PITT. L. REV. 349 (1969-1970).

109. *See* Charles Knapp, *Unconscionability in American Contract Law: A Twenty-First Century Survey* (University of Hastings College of Law, Legal Research Paper Series, Research Paper No. 71, 2013)) *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=2346498.

110. Elizabeth Warren & OrenBar-Gill, *Making Credit Safer*, 157 U. PA. L. REV. 1, 71 (2008). This article states that:

> Consumer credit transactions are regulated by the general law of contracts. The main doctrinal vehicle for policing these transactions is the unconscionability doctrine . . . . Unconscionability review is most commonly applied to contracts between consumers and sophisticated corporations, and it has been used to police credit contracts. Yet courts have been very circumspect in applying unconscionability review to credit contracts. As explained below, the reluctance of common law judges to intervene in credit transactions is justified by institutional, doctrinal, and procedural considerations. Moreover, with respect to interest rates and possibly other contractual

Despite this broad power, courts rarely use the doctrine. Judging by courts' scant modern use of this doctrine, one might assume that sharp, one-sided practices typical of unconscionable contracts must be on the decline.[111] In reality, nothing could be further from the truth. Compared to the time at which Ms. Williams, from the iconic *Williams v. Walker Furniture*,[112] case first signed a contract containing an unconscionable cross-collateralization clause, expensive and one-sided loan transactions have proliferated. While at least two scholars have suggested that unconscionability can play a critical role in policing payday and title lending interest rates and fees,[113] courts have been slow to use the doctrine to invalidate consumer loans.[114]

Perhaps courts use the doctrine infrequently because it is seen as messy, imprecise, and paternalistic. Applying the unconscionability doctrine to invalidate consumer loans also flies in the face of arguably more important contracts rules, namely that people are bound by the contracts they sign and also have a duty to read these contracts before they do sign them. Moreover, most consumers are likely unaware of the doctrine or of their right to challenge unfair contracts. Most probably assume they could not win a lawsuit against a big corporation. Perhaps they are right.

> provisions that form the centerpiece of credit contracts, unconscionability review is likely preempted by federal law.

Id. (footnotes omitted).

111. Robin West, *The Anti-Empathic Turn* (Georgetown Univ. Law Ctr., Research Paper No. 11-97 (2011)), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885079 (concluding that we have moved away from making moral or empathetic decisions, or even value judgments in the law, in favor of leaving people responsible for their own choices even if they are deceived).

112. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

113. William M. Woodyard & Chad M. Marzen, *Is Greed Good: A Catholic Perspective on Modern Usury*, 27 BYU J. PUB. L. 185, 220 (2012).

114. One context in which the doctrine *is* used regularly is in finding arbitration clauses in consumer contracts to be unenforceable. *See* Arriaga v. Cross Country Bank, 163 F. Supp. 2d 1189, 1194-95 (S.D. Cal. 2001)) (finding that a credit card contract's arbitration clause was neither procedurally nor substantively unconscionable), *cited in* Warren & Bar-Gil, *supra* note 110, at 71; Bank One, N.A. v. Coates, 125 F. Supp. 2d 819, 830-36 (S.D. Mass. 2001) (ruling against unconscionability even where an arbitration clause required plaintiff to bear arbitration fees and restricted available remedies); Marsh v. First USA Bank, N.A., 103 F. Supp. 2d 909, 920 (N.D. Tex. 2000) (holding that the arbitration was not unconscionable though the clause was not bargained for). Such claims have been upheld, but only in extreme cases. *See, e.g.*, Ferguson v. Countrywide Credit Indus., 298 F.3d 778, 785 (9th Cir. 2002) (showing that an arbitration clause that exempts drafters' claims is most likely to be unconscionable); Lozada v. Dale Baker Oldsmobile, Inc., 91 F. Supp. 2d 1087, 1105 (W.D. Mich. 2000) ("[A]n arbitration provision is substantively unconscionable because it waives class remedies, as well as declaratory and injunctive relief."). *See also* Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1274-75 (2003) (discussing arbitration-clause unconscionability cases).

i. History of Unconscionability

Unconscionability was part of the common law of contract as early as the 1800's but became more well-recognized after 1947 in *Campbell Soup Co. v. Wentz.*[115] In this case, two farmers agreed to sell all of their red cored carrots to Campbell's Soup Co. under terms that allowed the soup giant to reject all the carrots for any or no reason and that set very low liquidated damages for Campbell's breach.[116] This decision recognized an element of oppression in the unconscionability doctrine.[117]

Later, in *Williams v. Walker-Thomas Furniture Co.*[118] the District of Columbia Court of Appeals found that a contract between an impoverished, uneducated, woman and a seller of household goods could be unconscionable when the contract's fine print allowed the company to spread all remaining debt for one new item over all items purchased over the prior five years, essentially cross collateralizing the obligation and allowing the company to repossess all the items previously purchased and paid for, if the customer missed one payment on the new item.[119] In other words, no furniture was paid off until all of it was. Since the facts were not fully developed below, the court remanded the case back to trial and, in so doing, noted that unconscionability includes an absence of meaningful choice, which can be shown by a gross inequality of bargaining power on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party.[120] The *Williams* court also discussed the relevance of the circumstances surrounding the contract, such as whether the less powerful party had a reasonable opportunity to understand the terms of the contract or whether, instead, important contract terms were hidden in a maze of fine print and minimized by deceptive sales practices.[121] Thus, the *Williams* court clarified that, while most contracts are enforceable, when a party with little or no bargaining power and thus no practical choice enters into a one-sided contract with little or no knowledge of its terms, there is no realistic consent to the terms. Rather, the usual rule that the terms of the agreement are enforceable should be abandoned, and the court should consider wheth-

---

115. Campbell Soup Co. v. Wentz, 172 F.2d. 80 (3d Cir. 1948).
116. *Id.* at 81.
117. *Id.* at 83-84.
118. Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).
119. *Id.* at 447.
120. *Id.* at *449.*
121. *Id. See also* Ohio Univ. Bd. of Trs. v. Smith, 724 N.E.2d 1155, 1161 (Ohio Ct. App. 1999) (quoting *Williams*, 350 F.2d at 449); Morrison v. Circuit City Stores, Inc., 313 F.3d 646, 666 (6th Cir. 2003).

er the terms of the contract are so unfair that enforcement should be withheld.[122]

The Uniform Commercial Code codified the unconscionability doctrine when it was enacted in 1952, making the doctrine part of both statutory and common law. Not long afterwards, Yale law professor Arthur Leff, a vehement opponent of the doctrine, wrote an article claiming that in order for a court to use unconscionability to invalidate contract terms the court must find both procedural and substantive unconscionability.[123] While courts have not always been consistent in interpreting this distinction, procedural usually means unfairness in the formation of the contract and substantive usually means unfairness in the terms in the contract itself.[124] Substantive issues include one-sided terms, and procedural issues include a party's lack of choice, superior bargaining position or knowledge, and other circumstances surrounding the bargaining process.[125]

ii. Today's Law of Unconscionability

In considering whether to apply the doctrine today, courts typically look at the terms of the contract to determine if one party to the contract took advantage of its superior bargaining power so that the contract overwhelmingly favors the interests of that party. The doctrine is extremely flexible, which is part of its problem.[126] Today courts are split as to whether

---

122. *See Williams*, 350 F.2d at 449.

123. *See* Arthur Allen Leff, *Unconscionability and the Code—the Emperor's New Clause*, 115 U. PA. L. REV. 485, 487-88 (1967).

124. *See* Brown *ex rel.* Brown v. Genesis Healthcare Corp., 724 S.E.2d 250, 261-62 (W. Va. 2011), *vacated on other grounds*, 132 S. Ct. 1201 (2012); Strand v. U.S. Bank Nat'l Ass'n, N.D., 693 N.W.2d 918, 923 (N.D. 2005).

125. *Brown,* 724 S.E.2d at 261-62; *Strand*, 693 N.W. 2d at 923.

126. Christopher Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 TEMP. L. REV. 1, 37-38 (2005). Peterson notes that:

> In addition to usury law, state and local governments have passed other contract restrictive consumer credit protections such as caps on late fees or even the amount of points chargeable. Another more important example of contractual limitation policy in the United States is unconscionability law. Where rate, fee, and point caps set an inflexible, yet somewhat artificially contrived, bright line price limit, the unconscionability doctrine sets a loose *post hoc* judicial standard against unfair loans. The unconscionability doctrine dates at least back to the Roman doctrine of *laesio enormis*, also called the fair exchange doctrine, which invalidated grossly unfair contracts. Some have suggested unconscionability may have been imported into the common law tradition specifically as a response to high interest rates. Traditionally courts gave import to the unconscionability doctrine by denying relief to parties

you need both procedural and substantive unconscionably to invalidate contract terms.[127] Determining whether a contract is one of adhesion is not required before proceeding with an unconscionability analysis.[128] However, some courts incorporate the analysis of adhesion into the procedural analysis.[129]

> guilty of unconscionable conduct. The doctrine currently appears in the Uniform Commercial Code Article II, the Restatement (Second) of Contracts, and some consumer credit statutes.

Id. As Peterson notes, most courts now follow the influential analysis of Professor Arthur Leff delineating two types of unconscionability: procedural and substantive; and, while all "courts typically require 'some quantum of both procedural and substantive unconscionability to establish a claim," some do not. Maxwell v. Fid. Fin. Servs., Inc., 907 P.2d 51, 58-59 (Ariz. 1995), *quoted in* Christopher Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda,* 78 TEMP. L. REV. 1, 37-38 (2005). For example, "[i]n *Maxwell v. Fidelity Financial Services, Inc*., a door-to-door salesmen sold a hotel maid a solar water heater financed by a 19.5% loan secured by not only the water heater but also her modest home." *Id.*; *Maxwell*, 907 P.2d at 58-59 ("[W]e conclude that under A.R.S. § 47-2302, a claim of unconscionability can be established with a showing of substantive unconscionability alone, especially in cases involving either price-cost disparity or limitation of remedies."). Even though the water heater was improperly installed and never actually worked, the borrower made payments on this and a related loan for six years until she sued for a declaratory judgment that the original contract was unenforceable for unconscionability. *Id.* The Supreme Court of Arizona held that "[t]he apparent injustice and oppression" presented a triable issue of unconscionability even absent a finding of procedural unconscionability. *Id.* at 60. *See also* Carol M. Rose*, Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 577-78 (1988) (describing interest rate caps and fee limits as "crystals" and unconscionability as "mud").

127. New Mexico courts hold that you need one or the other, not both. *See, e.g.*, Rivera v. Am. Gen. Fin. Servs., Inc., 259 P.3d 803, 817 (N.M. 2011) (noting "the substantive unconscionability of the one-sided contract provisions was 'so compelling'" that addressing procedural unconscionability was unnecessary). *See also Maxwell*, 907 P.2d at 58.

128. An adhesion contract is a standardized contract form that offers goods or services to consumers on essentially a "take it or leave it" basis without giving consumers realistic opportunities to negotiate terms that would benefit their interests. When this occurs, the consumer cannot obtain the desired product or service unless he or she acquiesces to the form contract. *Adhesion Contract*, THE FREE DICTIONARY BY FARLEX, http://legal-dictionary.thefreedictionary.com/Adhesion+Contract (last visited Feb. 6, 2014). *See* Cordova v. World Fin. Corp. of N.M., 208 P.3d 901, 910 (N.M. 2009). *See also Rivera,* 259 P.2d at 817; Guthmann v. La Vida Llena, 709 P.2d 675, 678 (N.M. 1985) (laying out the elements of an adhesive contract).

129. *Cordova*, 208 P.2d at 910-11. *Rivera* noted that "[a]dhesion contracts generally warrant heightened judicial scrutiny because the drafting party is in a superior bargaining position." *Rivera*, 259 P.3d at 817. *Rivera* formally reversed a court of appeals opinion applying the unconscionability standard from *Cordova*. *Id.* at 819. The New Mexico Supreme Court did so because they felt the court of appeals had misapplied the central holding of *Cordova*, and the court was concerned that an arbitrator might otherwise apply erroneous precedent. *Id.* at 816. Adhesion is not synonymous with unconscionability; instead, when "the terms are patently unfair to the weaker party" there is procedural unconscionability. *Id.* at 817 (quoting *Cordova*, 208 P.3d at 910).

iii. Unconscionability and Consumer Lending

Though one commentator claims that the use of the doctrine may be on the upswing,[130] cases in which unconscionability has been applied to consumer loans are few and far between. One example is *Carboni v. Arrospide*,[131] in which the court found that an interest rate of 200% on a secured loan of $99,000 was substantively unconscionable because the cost to the borrower was "overly harsh" and "not justified by the circumstances."[132] In *Carboni*, the "'price' of the credit" was found to be approximately ten times the value of the loan because the interest rate was ten times the prevailing rate for the same type of loan.[133] In making its decision, *Carboni* relied on decisions in which the price to value ratio was one to three to one to four.[134] However, the price to value ratio was not dispositive; rather, the linchpin was the lack of justification for the ratio.[135] *Carboni* notes that a one-sided term or result might be justified, but without such justification, a one-sided term is likely unconscionable.[136]

What might be the justification for the current payday and title loan rates of twenty to seventy-five times the prevailing rate? That people need money and this is the only way to get it? Lenders would need to prove this need, which may not be as easy as one might assume.[137] In *Carboni*, the lender argued that a more "conventional" loan would have an interest rate at about 18% to 21% plus costs. The lender further argued that the debt could have been paid off early, thereby avoiding much of the ballooning interest.[138] Both arguments failed and the trial court adjusted the rate in the case to 24%, which was affirmed.[139]

---

130. Knapp, *supra* note 109, at 17.

131. Carboni v. Arrospide, 2 Cal. App. 4th 76, 83-84 (1991).

132. *Id.*

133. *Id.*

134. *Id.* (citing Jones v. Star Credit Corp., 298 N.Y.S.2d 264 (1969); Frostifresh Corp. v. Reynoso, 274 N.Y.S.2d 757 (1966)).

135. *Id.*, 2 Cal. App. 4th at 84. *S*ome aspects of the facts seem to go more to procedural unconscionability, showing that courts have trouble making this substantive/procedural distinction.

136. *Carboni*, 2 Cal. App. 4th at 84.

137. In any case, it is possible that the need that payday loans fill is a need created by payday borrowing itself, which creates a debt cycle and makes it less likely that consumers will be able to pay other bills, because they now have a 500% or 1,000% loan to pay every two weeks or month. Deena Reynolds, Note, *A Look at Payday Loans and Current Regulation in Texas*, 8 TEX. TECH. ADMIN. L.J. 321, 325-26 (2007).

138. *Carboni*, 2 Cal. App. 4th at 84.

139. *Id.* at 87.

iv. Unconscionability and High-Cost Loans

In the particular context of high-cost loans, courts of at least four states have recently considered whether high-cost loans are unconscionable. In *Johnson v. Cash Store*,[140] a woman entered into a series of payday loans through which she paid back double her $500 loan, lost her trailer residence to foreclosure, and owed a deficiency of $20,000 to her lender. Suing under an unconscionability provision in the state's consumer protection law, she obtained a default judgment with treble damages, plus $15,000 in emotional distress damages, which the state court refused to vacate.[141] The court was not convinced by the argument that because the state financial institutions division had licensed the lenders, the loans could not be unconscionable.[142] This is fortunate, given the utter failure of state level licensing entities (or their authorizing statutes) to regulate high cost lending in any way. Additionally, in Wisconsin, a loan with an APR of over 1,000% was deemed substantively unconscionable, despite the fact that the state had imposed no interest rate cap through legislation.[143] In California, a court certified a class for a class action in a payday loan case involving claims for excessive interest and fees, oppressive collection efforts, and various other allegedly illegal practices.[144]

Two recent New Mexico cases, however, demonstrate how unconscionability fails to provide what only federal legislation can—namely consistency and predictability. In *King v. B&B Investment Group, Inc.*, Cash Loans Now made signature loans ranging in amount from $50 to $300 at an APR ranging of 1147% to more than 1500%.[145] These loans were amortized over a year long repayment term. If paid in full under the terms of the loan, the borrowers paid ten to fifteen times what they borrowed over the course of a year. For example, consumer Mr. Welito borrowed $100 and paid back $1,099.71, and Ms. Charley borrowed $200 and paid back $2,360.04.[146] A suit brought by the New Mexico Attorney General's Office (NMAG) claimed that the price of the credit was unconscionable on its face, as a matter of public policy.[147] While the NMAG did not ask the court to determine what a reasonable amount of interest would be under the circumstances, the

140. Johnson v. Cash Store, 68 P.3d 1099 (Wash. Ct. App. 2003).

141. *Id.* at 1106.

142. *Id.*

143. Payday Loan Stores of Wisconsin, Inc. v. Mount, 2011 WL 2577365 (Wis. Ct. App 2010), *cert. granted*, 804 N.W.2d 82 (2011).

144. O'Donovan v. CashCall, Inc., 278 F.R.D. 479 (N.D. Cal. 2011).

145. New Mexico *ex rel.* King v. B & B Inv. Grp., No. D-01010CV-2009-01916 1, 1-2 (1st Dist. N.M. Dec. 3, 2010) (on file with author).

146. *Id.* at 1-2.

147. *Id.* at 23.

court was asked to hold that these amounts were unconscionable on their face.[148]

In addition to causing the borrowers to pay back ten to fifteen times what they borrowed, Cash Loans Now did not disclose the total costs of these loans to their patrons[149] and also regularly contacted borrowers to try to get them to borrow more,[150] collectively causing the trial court to find procedural unconscionability in the case. The trial court found that Cash Loans Now borrowers were less educated than the general population, were likely to come from minorities, and suffered from optimism bias, temporal biases, and framing biases, particularly given that the loans were often described to consumers in terms of a small daily cost.[151] Moreover, the court found that the lender's stated policy, of calling all active files regularly to get the people to increase the principal or let people know they can re-borrow, exploited customer optimism.[152] The trial court also found the installment contracts to be contracts of adhesion[153] and that the borrowers' various cognitive biases impaired their understanding of how the loans worked, as well as borrowers' understanding of their ability to pay back the loans. [154] The trial court also found that these APRs—of over 1000%—were "shocking."[155] Thus the court found procedural unconscionability but not substantive unconscionability, and held a second trial to set damages.[156]

At the second trial, however, the trial court allowed no recovery in the case.[157] The trial court found that there was no great disparity between what the borrowers received and what they got.[158] Tellingly, in the first opinion, the trial court did not find it to be its place to find substantive unconscionability, yet it found all of the elements of substantive unconscionability. It refused to declare an interest rate of 1,000% to be unconscionable, despite that the unconscionability doctrine is available only to courts and that these rates can hardly be conscionable by any standards.[159]

148. *Id.*

149. *Id.* at 18.

150. *B & B Inv. Grp.*, No. D-01010CV-2009-01916 at 18.

151. *Id.* at 3-6, 17. For example, if the cost of a loan is framed as something low, the borrower's expectations can be anchored in that perception, making it difficult for him or her to reassess the true cost and risk of the loan once they get additional information. *Id.* at 16.

152. *Id.* at 18.

153. *Id.* at 19.

154. *B & B Inv. Grp.*, No. D-01010CV-2009-01916 at 19.

155. *Id.* at 19.

156. *Id.* at 23.

157. New Mexico *ex rel.* King v. B & B Inv. Grp., No. D-101-CV-2009-01916 1, 20-21 (Dec. 8, 2011) [hereinafter *B & B Second Opinion*] (on file with author).

158. *Id.*

159. The court also found that it would be too harsh a penalty to force defendants out of business in New Mexico despite the fact that very few places in this country welcome

In other words, the court found that it was not its place to use the unconscionability doctrine to invalidate the loans. The court claimed that it was the place of the legislature to set the rate and that the legislature had not done so for this type of loan. The court found no substantive unconscionability, no recovery for mere procedural unconscionability,[160] and that there was no law against these loans on the books, despite the fact that payday loan laws existed for a similar product and capped interest at a rate lower than what Cash Loans Now was charging.

Scholars have clearly articulated that it is the place of courts to police these transactions and that courts unquestionably have that right if there is no law on the books to the contrary.[161] This understanding is completely consistent with the history, development, and policies behind the doctrine of unconscionability. Despite that it is clearly the role of courts to use the doctrine in precisely this way, courts do not always do so.

Then again, sometimes they do, as evidenced by the results in *King v. FastBucks Holding Corp*., a similar case in the same state.[162] In *King v. FastBucks*, the court found that borrowers who used FastBucks products, mostly installment-style loans following the changes in law in New Mexico in 2007, were less educated and had lower incomes than average.[163] The borrowers also were found to not know the difference between payday loans and installment loans, which is no wonder since these differences were never disclosed to them.[164] The court further found that FastBucks took advantage of borrowers' lack of knowledge, ability, experience, or capacity to a grossly unfair degree by deliberatively steering borrowers into loans that subjected them to higher interest rates and kept them locked into recurring cycles of debt.[165] The court further found that FastBucks intentionally steered customers to the most expensive products it offered in order to increase profits and provided incentives to employees who did so. As the court stated:

---

these loans, and in many states, they have been put out of businesses or never got into business in the first place. *B & B Inv. Grp.*, No. D-01010CV-2009-01916, at 19.

160. There was a separate trial for damages, and the court found none on the theory that there was no need to provide restitution to borrowers, because the Plaintiffs did not properly offset their request for damages by the intangible "value" borrowers received from being able to borrow from Cash Loans Now, and also that any restitution award short of the requested amount would be arbitrary. *B & B Second Opinion*, No. D-101-CV-2009-01916 at 20-21.

161. *See* CAL. CIV. CODE § 1789.12(a)(1)-(3) (West 2008).

162. *See* New Mexico v. Fastbucks Holding Corp., No. D0101-CV-2009-01917 (N.M. Sept. 26, 2012).

163. *Id.* at 2.

164. *Id.* at 4.

165. *Id.*

> Rose Figeroa testified that "[w]e just don't let anybody pay off," and that "[w]e tell them how their tax refund is better used at Wal-Mart . . . than at FastBucks, and we basically talk them into making a payment and continuing to be our customer." She was congratulated for her approach and used as an example for how other employees of [FastBucks] could conduct themselves to earn the conspicuous financial rewards that were imparted upon her.[166]

The court further found that FastBucks encouraged customers to use one loan to pay off another and that the customer's lack of knowledge, combined with the superior knowledge of FastBucks, the smooth sales talk, and the explicit desire to steer customers away from 400% payday loans and into 520-650% installment-style loans, took advantage of customers' lack of knowledge and the intricacies of the loans to a grossly unfair degree.[167] Noting that one customer paid $4,680.48 for an $800 installment loan, the court found a pattern of "manufacturing exorbitantly expensive repayment obligations through their use of installment loan products."[168] The court further found that FastBucks knew that customers would be unable to pay back these loans. This fact, along with FastBucks's obvious attempt to get around existing law, constituted unconscionable lending practices under New Mexico's Unfair Practices Act.[169] The court ordered restitution in an unliquidated amount, estimated by the New Mexico Attorney General's Office at over $20 million.[170] This victory, however, would also prove empty, at least in the short term, as the next section explains.

2. *The Chapter 11 Bankruptcy Option: More Evidence of State Court Impotence*

Naturally, lender bankruptcies cause further delays. As an example, three months after the NMAG's Office obtained a judgment against FastBucks estimated at $20 million,[171] FastBucks filed for Chapter 11 bankrupt-

---

166. *Id.* at 3.
167. *Fastbucks Holding Corp.*, No. D0101-CV-2009-01917 at 4.
168. *Id.* at 5.
169. *Id.* at 5-6. *See also* N.M. STAT. ANN. §57-12-2.E(1)-(2) (2009).
170. *See* Press Release, Attorney General's Office, AG: FastBucks Pulls Fast One on NM Consumers: Predatory Loan Practices Continue Despite Court Order (Jan. 28, 2013) (on file with author)
171. Because of FastBucks's Bankruptcy, the judgment was never actually liquidated. Unsworn declaration of Charles A. Horton in Support of Emergency Motions at 4, *In re* Fastbucks Holdings Corp., No. 12-37793-11 (N.D. Tex. Dec. 12, 2012) [hereinafter Horton

cy protection.[172] The automatic stay imposed by section 362 of the Bankruptcy Code stopped the NMAG's collection efforts, at least for a while, and allowed FastBucks to further strategize about how to avoid the implications of this potentially large judgment.[173] FastBucks's bankruptcy case obviously delayed the enforcement of the judgment.

The required Chapter 11 disclosures and various motions in the case also provide further evidence of the inefficiency of the current high-cost lending regulatory structure. In its initial filings with the courts, FastBucks claimed it exists because of a lack of credit to credit-challenged consumers, who were essentially abandoned by traditional banks.[174] It also claimed that following banks' abandonment of these consumers, loans to this sector have grown to a $45 billion industry, when considering "both brick and mortar branches and online lenders."[175]

These initial disclosures also clarify that FastBucks had never been late on any of its obligations and that the primary reason for the bankruptcy filing was the NMAG's Office judgment.[176] FastBucks also disclosed that it generated $16.4 million in revenues in 2011, through the operation of sixty

---

Declaration]. A previous blog had described the state court litigation in New Mexico that led to the filing of FastBucks bankruptcy:

> The post described how the court found that FastBucks employees encouraged borrowers to not pay off loans, which loans were found to violate state law. We in New Mexico, where the case was brought, watched to see if the FaskBucks shops would close down, but they never did. Rather, FastBucks filed some motions and an appeal in state court, then filed for Chapter 11 on December 10, 2012. Their largest creditor? The State of New Mexico.

Nathalie Martin, *Interesting Automatic Stay Decision in FastBucks Chapter 11 Case*, CREDIT SLIPS (Apr. 9, 2013 11:44 AM), http://www.creditslips.org/creditslips/payday_lending/.

172. FastBucks Bankruptcy Petition, *In re* Fastbucks Holdings Corp.,No. 12-37793-11 (N.D. Tex. Dec. 10, 2012), *available at* http://www.creditslips.org/creditslips/payday_lending/. The parties that filed included FastBucks Holding Corporation, FastBucks, Inc., FastBucks Wage and Benefits, LLC, FastBucks of Alamogordo, New Mexico, LLC, FastBucks of Gallup, New Mexico, LLC, FastBucks of Rio Rancho, New Mexico, LLC, FastBucks of Las Vegas, New Mexico, LLC, and FastBucks of Roswell, New Mexico, LLC (collectively, "FastBucks" or "the Debtors").

173. 11 U.S.C. § 362(a) (2012). *But see* 11 U.S.C. § 362(b)(4) (allowing a municipality to continue any legal action against a debtor in order to protect the health and welfare of citizens). The NMAG ultimately obtained an order allowing it to proceed to collect its judgment on the grounds that the judgment protected the health and public welfare of the people of the state under section 362(b)(4). *See id.*; Order Denying Plaintiffs' Complaint and Application for Preliminary Injunction, *In re* FastBucks Holding Corp., No. 12-37793-11 (N.D. Tex. Mar. 4, 2013).

174. Horton Declaration, *supra* note 171, at 3.

175. *Id.*

176. *Id.* at 6.

branches throughout Texas, Nevada, New Mexico, Idaho, and Utah.[177] Business in New Mexico, the nation's third poorest state,[178] was particularly fertile, with a total of twenty-eight of sixty stores generating approximately 58% of FastBucks's revenues.[179]

FastBucks ultimately argued that the NMAG's attempts to enforce its state court judgment finding FastBucks loans to be unlawful, as well as the NMAG's attempts to inform customers that they did not need to repay their loans, interfered with FastBucks's business and violated the automatic stay.[180] The bankruptcy court disagreed, finding no stay violation and refus-

177. *Id.* at 4.

178. *State and County Quick Facts*, U.S. CENSUS BUREAU (Jan. 6, 2014), http://quickfacts.census.gov/qfd/states/35000.html (showing a poverty rate of 19% compared to a national average of 14.9%).

179. Complaint and Application for Preliminary Injunction, *In re* Fastbucks Holdings Corp., No. 12-37793-11, at 4 (N.D. Tex. Feb. 4, 2013) [hereinafter Complaint to Enjoin NMAG]. FastBucks claimed to have approximately 160 employees, all non-union, many of whom have a unique expertise understanding the debtor's infrastructure and operations. Horton Declaration, *supra* note 171, at 11. Indeed, the debtor recently brought a lawsuit against one who allegedly stole some of these trade secrets. Motion of Debtors Pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure for an Order Approving Compromise and Settlement Agreement with Debbie Lopez and Cash Station, Inc., *In re* Fastbucks Holdings Corp., No. 12-37793-11 (N.D. Tex. Feb. 4, 2013).

180. Complaint to Enjoin NMAG, *supra* note 179, at 19-22. Shortly after filing its bankruptcy case, FastBucks argued that NMAG's attempts to collect its judgment and to inform consumers that FastBucks's loans were illegal under state law interfered with its business. *Id.* at 2-3. As a result, FastBucks asked the bankruptcy court to enjoin the Attorney General's office from:

> 1) issuing press releases or publicly commenting regarding [FastBucks or] their bankruptcy cases . . .
>
> 2) contacting [FastBucks's] customers [about the loans], to seek out information concerning customers' loans, or to advise to [the FastBucks's] customers or other members of the public who may contact the Attorney General's office . . . [and]
>
> 3) attempting to enforce [a New Mexico state court's order finding FastBucks loans to be illegal].

Id. FastBucks claimed that allowing NMAG to issue any press releases in the case, or even speak publicly about the case, could hurt FastBucks's business, that its loans are "perfectly legal under New Mexico law," *id.* at 4, and that New Mexico has a robust regulatory scheme, despite the fact that all consumers over thirty days long are essentially completely unregulated. *Id.* at 6. FastBucks further claimed in its complaint that the court's order finding their loans unconscionable is unconstitutional because only the state regulatory authority, the New Mexico Financial Institutions Division, can declare their actions illegal, not courts. Complaint to Enjoin NMAG, *supra* note 179, at 6-9. FastBucks notes that the regulatory agency in charge, the New Mexico Financial Institutions Division (FID) has given FastBucks a license to make loans each time it has requested such a license and that it is clear from this action that the FID has no problem with FastBucks's business. *Id.* at 6. Again, never in history has the FID taken any action to curb harmful lending practices. These arguing to enjoin the NMAG from issuing future press releases or talking about the case publicly, on First Amendment grounds.[181] The bankruptcy court held that since FastBucks neither complied with the state court's order nor had the final order set aside, FastBucks "cannot seriously complain that enforcement would cause harm to [their] business and accounts receivable. It is well established that those seeking equity must do equity."[182]

In connection with a motion by the NMAG to exclude its actions from the automatic stay, FastBucks claimed that the NMAG is not protecting the public from anything because "the Attorney General [would] need to sue each lender and collect a similar type of judgment, in order to impose interest rate caps on installments loans throughout New Mexico."[183] Using the inefficiency of state courts in policing high-cost credit to its advantage, FastBucks relied heavily on the fact that another court in the same exact state found no liability under similar circumstances.[184] FastBucks further argued that if the other lender won under these circumstances and facts, it must win too.[185] Whether the argument is frivolous or meritorious, the result is the same. This lender is still making loans in a state in which the loans have been outlawed by a state court.

3. *Anti-Class Action and Arbitration Clauses Further Limit Customer Enforcement of the Law*

The lack of a federal usury cap really stings consumers in light of recent Supreme Court jurisprudence in the area of anti-class action and arbitration clauses in consumer contracts. Payday and title loans contracts often

---

ments by lenders demonstrate why it is so difficult for courts to use unconscionability to police high costs loans. *Id.* at 8. FastBucks also claimed that the entire lawsuit by the New Mexico Attorney General's Office was nothing but an attempt to harass FastBucks and put it out of business. *Id.* at 20. FastBucks further claims that the NMAG suit and the NMAG's subsequent contacts with consumers in New Mexico constitute an interference with FastBucks's business and its account receivable. *Id.* at 13. As evidence, FastBucks noted that since the state court found its loans to be unconscionable, bad loans have increased from 4.7% to 16.5%. Complaint to Enjoin NMAG, *supra* note 179, at 19-22.

181. Order Denying Plaintiffs' Complaint and Application for Preliminary Injunction, *In re* Fastbucks Holdings Corp., No. 12-37793-11 (N.D. Tex. Mar. 4, 2013).

182. *Id.* at 5. In the context of the Complaint to Enjoin NMAG, FastBucks told the bankruptcy court that after NMAG's press release, customers not only stopped paying, but a few even called and claimed that FastBucks was overcharging them. Complaint to Enjoin NMAG, *supra* note 179, at 21. NMAG ultimately requested that the bankruptcy court clarify that its actions to enforce its judgment were not stayed under section 362(b)(4) because these actions fall within NMAG's police power and protect the health and welfare of the people of New Mexico. *Id.* at 17.

183. *Id.* at 18.

184. *Id.* at 18-19.

185. *Id.*

contain clauses requiring that all disputes be resolved in arbitration and also that limit a customer's right to participate in any class action related to the loans. Once thought to be unconscionable, these clauses are now generally enforceable under the U.S. Supreme Court decision, *AT&T Mobility LLC v. Concepcion*,[186] which resolved a split in the circuits and explicitly upheld the ability of companies to use arbitration clauses to exempt themselves from class actions.[187] While the precise impact of *Concepcion* is yet to be determined, the Court's holding makes it clear that companies can avoid not only court trials but also class-wide arbitration proceedings simply by incorporating a class arbitration waiver within the scope of an arbitration provision.[188] As recognized by Justice Stephen Breyer in his dissenting opinion in *Concepcion*, "[t]he *realistic* alternative to a class action is not 17 million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for $30."[189] The obvious result is that consumers with low dollar complaints against any business will be less able to pursue their claims.[190]

4. *Even with Caps, State Usury Laws Are Inefficient and Ineffective*

Sometimes states have interest rate caps, but lenders ignore them anyway. In a recent large-scale debt collection action in Arkansas, a state with an 18% interest rate cap for all loans, a Kansas debt collection agency bought a huge book of payday loans made to Arkansas citizens, none of which were enforceable under Arkansas law.[191] The debt collection agency ultimately agreed to cancel more than $2.7 million in payday loan debts of Arkansans and will pay the state $200,000 to settle a lawsuit over its collection efforts.[192] The State Attorney General's Office had to use extensive resources to garner the settlement, which should never have been necessary in the first place.[193] The collector had misrepresented to thousands of Arkansas consumers that the debts it attempted to collect were enforceable and collectible, even though they were clearly illegal under Arkansas

---

186. AT&T Mobility v. Concepcion, 131 S. Ct. 1740, 1740 (2011).

187. Todd Seaman, Note, *Drowning in the Wake of Concepcion: How to Protect Small Claims Plaintiffs Bound by Mandatory Arbitration Agreements*, 73 OHIO ST. L.J. 49, 50 (2012).

188. *Id.*

189. *Concepcion*, 131 S. Ct. at 1761 (Breyer, J., dissenting) (citing Carnegie v. Household Int'l, Inc., 376 F.3d 656, 661 (7th Cir. 2004)), *quoted in* Seaman, *supra* note 187.

190. *Id.*

191. *Settlement Ends Bid to Collect on Payday Loans*, ARKANSAS NEWS (Mar. 28, 2013), http://arkansasnews.com/sections/news/arkansas/settlement-ends-bid-collect-payday-loans.html.

192. *Id.*

193. *Id.*

law.[194] The company may face additional monetary penalties if it fails to notify affected consumers in writing that their debts have been cancelled, creating yet another enforcement obligation for state attorneys general.[195] While lenders could also ignore federal interest rate caps, this would be less likely. The state law patchwork makes it complicated to learn each state laws and a federal cap could eliminate that complication once and for all.

V. WHY MAKE A FEDERAL CASE OUT OF THIS, RATHER THAN ENCOURAGING STATES TO IMPLEMENT A 36% CAP?

Given the failure of states, a federal cap is the only option left. Coordinating fifty states on this or any issue is complex and difficult work. Congress, on the other hand, need pass just one law to accomplish a national usury cap. Consumers can and do cross borders to borrow money, and states have no particular interest in caps. Moreover, the entire country is a common market, such that any state's regulation of interest rates inherently reaches across borders. Thus, there is a need for uniformity on interest rates across those borders, which only Congress can provide.[196]

Congress unquestionably has the power to set federal interest rate caps through the commerce clause of the U.S. Constitution.[197] Indeed, in recent years the regulation of consumer credit has become even more of a federal, rather than a state, regime.[198] Additionally, Congress already has experience setting a 36% cap that protects some, but not all, Americans. In 2007, Con-

---

194. *Id.*

195. *Id.*

196. Need for uniformity is one obvious reason for the federal government to come in and legislate. *See* Amelia H. Boss, *The Future of the Uniform Commercial Code Process in an Increasingly International World*, 68 OHIO ST. L.J. 349, 356 (2007); Charles W. Wolfe*, Section 1324 of the Food Security Act of 1985: Congress Preempts the 'Farm Products Exception' of Section 9-307(1) of the Uniform Commercial Code*, 55 UMKC L. REV. 454, 456 (1987).

197. U.S. CONST. art. 1, § 8, cl. 3. *See also* Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 STAN. L. REV. 115, 171-73 (2010). Indeed, there are numerous examples of federal consumer protection laws, including TILA, HOEPA, and the recent Card Act. *See, e.g.*, 15 U.S.C. § 1601 (2006).

198. *See* Elizabeth R. Schlitz, *Damming Watters: Channeling the Power of Federal Preemption of State Consumer Banking Laws*, 35 FLA. ST. U. L. REV. 893, 928 (2008). *See also* Boss, *supra* note 196, at 353-54. Professor Boss notes that when the Uniform Commercial Code process was first promulgated, there was a struggle between state and federal law and the process of enacting even the uniform statute was left up to states because of deep antifederalism sentiments stemming way back. *Id.* States believed that each of them was unique and that federal intrusion into state commercial law could lead to federal domination over states. *Id.* This fear was exacerbated by the fact that most of the members of Congress came from rural backgrounds where fear of federal control was even stronger. E. Hunter Taylor, Jr., *Uniformity of Commercial Law and State-by-State Enactment: A Confluence of Contradictions*, 30 HASTINGS L.J. 337, 361-62 (1978).

gress passed the Military Lending Act (MLA),[199] which purported to place a 36% interest rate cap on consumer loans and to prohibit lenders from engaging in predatory practices toward active-duty military members and their dependent family members.[200]

In passing the MLA, military lenders were deeply concerned about the effects of predatory lending on military readiness. When they realized state lawmakers were unable or unwilling to pass laws protecting the troops, these leaders focused their efforts on passing federal legislation.[201] In 2006, the United States Department of Defense (DOD) issued a report finding "that payday lending 'harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force.'"[202] Congress noted that lenders were blatantly targeting the military by clustering in large numbers "near military bases" and using "military-sounding names"[203] and

---

199. 10 U.S.C.A. § 987(b) (West, Westlaw current through P.L. 113-74 approved 1-16-14); 32 C.F.R. § 232.4(b) (2007).

200. 10 U.S.C.A. § 987(b); 32 C.F.R. § 232.4(b). While it is unclear from the legislative history which constitutional authority was used to pass the MLA itself, a 2013 amendment was passed under this authority:

> The constitutional authority on which this bill rests is the power of Congress "to provide for the common Defense", "to raise and support Armies", "to provide and maintain a Navy" and "to make Rules for the Government and Regulation of the land and naval Forces" as enumerated in Article I, section 8 of the United States Constitution.

See H.R. 4310, 112th Cong. (2d Sess. 2013), which amended the Military Lending Act in 2013 (P.L. 112-239). Military Lending Act, 10 U.S.C. § 987, added Oct. 17, 2006, P.L. 109-364, Div A, Title VI, Subtitle F, § 670(a); amended Jan. 2, 2013, P.L. 112-239, Div A, Title VI, Subtitle G, §§ 661(a), (b), 662(a), (b), 663.

201. Johnson, *supra* note 7, at 661.

202. U.S. DEP'T OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS (Aug. 9, 2006), *available at* http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf, *cited in* Johnson, *supra* note 7, at 661. In Senate hearings on the MLA, Duncan Hunter (R-Cal.) thanked members of Congress for ensuring that our troops have a good situation now and will not be the victims of loan sharks. *Id.* at 667. "Similarly, Senator Richard Durbin (D-Ill.) criticized the practice of rollovers and commented that '[p]ayday lenders are legal loan sharks that offer small, short-term loans at interest rates of 100, 500, even 1,000 percent.'" *Id.* at 661.

203. Johnson, *supra* note 7, at 668. Researchers could identify the types of businesses targeting military personnel around military bases by conducting electronic searches. *Id.* Perhaps more obviously, senators argued that payday loans interfered with military preparedness by interfering with security clearances and also by making it so that soldiers cannot devote their attention to their jobs. This in turn negatively affects their performance. *Id.* at 672. As explained by Republican Representative Walter Jones, Jr.,"[w]hen relatively unsophisticated borrowers are unable to readily repay a loan from these lenders, they can become consumed with worries over their debt and this undercuts their abilities to fulfill their military duties." 151 CONG.. REC.. E1487-01 (daily ed. July 14, 2005) (statement of Rep. Jones), *quoted in* Johnson, *supra* note 7, at 668. The MLA purports to impose a 36% APR cap on payday loans, vehicle title loans, and tax refund loans to active-duty military personnel and

also that military personnel lacked sophistication in financial matters and were easily taken advantage of.[204]

While there was early evidence that the MLA curbed predatory lending to military communities,[205] more recent evidence suggests that *even* the MLA is mired by loopholes. A recent news story recounts how loopholes in the MLA:

> threaten to leave hundreds of thousands of service members across the country vulnerable to potentially predatory loans — from credit pitched by retailers to pay for electronics or furniture, to auto-title loans to payday-style loans. The law, the au-

their dependents. Johnson, *supra* note 7, at 662. The definition of annual percentage rate in the MLA is broader than the definition under the Truth in Lending Act and is called the Military APR (MAPR) *Id.* The MAPR was intended to keep lenders from misleading military borrowers and requires them to include all of their fees in the MAPR calculation. "The MLA restricts a lender's ability to debit [a] borrower's bank account unless the loan complies with the MAPR calculation and the MAPR is capped at 36% or less." *Id.* at 662. Additionally, "[t]he MLA also preempts any inconsistent state or federal laws[,] . . . prohibits rollovers, and prohibits lenders from distributing multiple loans simultaneously to a military borrower." *Id.* at 663. Finally, "[t]he MLA applies to *all* financial institutions . . . so long as their loans are defined as payday loans and it makes any agreement to arbitrate disputes" with a military member unenforceable. *Id.* at 663.

204. Johnson, *supra* note 7, at 671. For example, Senator Jim Talent (R-Mo.) argued that payday lending "is ruining the financial lives of thousands of our service men and women who unknowingly, because of their lack of sophistication, get into debts from these abusive lenders, far greater than they are able to pay." 152 CONG.. REC.. S6405, S6406 (daily ed. Jun. 22, 2006) (statement of Sen. Talent), *quoted in* Johnson, *supra* note 7, at 671. He further noted that the young age and lack of higher education of many soldiers set them up for financial predation. Johnson, *supra* note 7, at 671.

205. After Enactment of the MLA, payday loans decreased and affordable loans increased. As Professor Johnson recounts, "[t]he success in the decrease in payday loans is not attributable solely to passage of the MLA but also to an increase in education outreach directed to military families and an increase in the supply of affordable loans." Johnson, *supra* note 7, at 664. Moreover, several military societies began to offer smaller value interest-free loans and gave service members assistance on creating budgets and repayment plans. Politicians and military leaders also stepped in and influenced banks and credit unions near military bases to offer low-interest loans:

> [I]n its 2008 report on implementation of the regulations adopted under the MLA, the DOD stated that several banks and credit unions were offering low-cost loans to military families at hundreds of military installations worldwide and military families were increasingly using these loan products. The Defense Credit Union Council, for instance, had 47 credit unions offering low-cost loans and lines of credit at 135 military installations. The average interest rate on these loans was a 17% APR with no additional fees.

Id. at 665.

> thorities say, has not kept pace with high-interest lenders that focus on servicemen and women, both online and near bases.[206]

The Consumer Federation of America has reported twice on the loopholes.[207] As Jean Ann Fox and her cohorts report, the MLA protections, including the 36% military annual percentage rate, apply to only certain types of payday and vehicle title loans as defined by a Department of Defense rule adopted in 2007.[208] Given the limited definitions of loans covered, the MLA limits interest and otherwise applies *only to* payday loans with a term of ninety-one days or shorter, in which the amount financed does not exceed $2,000 and in which the borrower pays with a post-dated check[209] and title loans with a term of 181 days or fewer that is secured by the title to a motor vehicle that has been registered for use on public roads and owned by a covered borrower.[210]

---

206. Jessica Silver-Greenberg & Peter Eves, *Service Members Left Vulnerable to Payday Loans,* N.Y. TIMES (Nov. 21, 2013), http://dealbook.nytimes.com/2013/11/21/service-members-left-vulnerable-to-payday-loans/?_r=1.

207. FELTNER, FOX & UDIS, *supra* note 29, at 1. This report is an update to a prior reported entitled, JEAN ANN FOX, CONSUMER FED'N OF AM., THE MILITARY LENDING ACT FIVE YEARS LATER (2012), *available at* http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf.

208. 10 U.S.C.A. § 987(b) (West, Westlaw current through P.L. 113-74 approved 1-16-14), *cited in* FELTNER, FOX & UDIS, *supra* note 29, at 1; 32 C.F.R. § 232.4(b) (2007), *cited in* FELTNER, FOX & UDIS, *supra* note 29, at 1.

209. FELTNER, FOX & UDIS, *supra* note 29, at 3. More specifically, this section provides that these protections apply to a transaction in which the lender either:

> a. Receives funds from and incurs interest and/or is charged a fee by a creditor and provides a post-dated check or other payment instrument to the creditor who agrees with the covered borrower not to deposit or present the check or payment instrument for more than one day, or;
>
> b. Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days.

Id. at 1-2.

210. *Id.* at 3. For the loans covered, the rule prohibits lenders from:

> 1. Charging more than 36 percent annual interest, which includes most fees (but not late or default fees) and any premiums for credit insurance sold in conjunction with the loan. This inclusive interest rate cap is stated as the Military Annual Percentage Rate (MAPR).
>
> 2. Securing a loan with a personal check or other access to the borrower's bank account, title to a personal vehicle, or requiring payment by military allotment.

The MLA has loopholes but is far better than most state laws at limiting those loopholes. As "[t]he Consumer Financial Protection Bureau's [recent] white paper entitled *Payday Loans and Deposit Advance Products* [reports], variations of the traditional two-week payday loan, including longer-term payday installment and open-end payday loans, are common and often driven by state law."[211] Indeed, both the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency have found "that open-end deposit advance loans made by depository institutions, or bank payday loans, posed many of the same problems as other payday loans."[212]

These comments further demonstrate the limits of state law in regulating high-cost lending. On the other hand, despite its limitations, the MLA demonstrates that Congress can impose federal caps and can now learn from whatever mistakes were made in the MLA. Federal, as opposed to state, laws provide general benefits that are equally beneficial here. Professor Creola Johnson forcefully argues that many military families are better

---

> 3. Charging prepayment penalties and engaging in roll-overs, renewals, refinancing or consolidation unless the renewal is at better terms for the borrower, such as a lower cost.
> 4. Including mandatory arbitration clauses, waiver of legal rights, and onerous legal notices in case of disputes in the loan contract.

32 C.F.R. § 232.3(b) (2007), *cited in* FELTNER, FOX & UDIS, *supra* note 29, at 3

211. CONSUMER FIN. PROT. BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS, A WHITE PAPER OF INITIAL DATA FINDINGS 8 (2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf, *cited in* FELTNER, FOX & UDIS, *supra* note 29, at 3. This means that the law does not cover:

> Payday loans with a loan term longer than 91 days; or vehicle title loans with a loan term longer than 181 days;
> [p]ayday, car title, or tax refund loans that are structured as open-end credit, including payday loans made by banks;
> [p]ayday loans for amounts larger than $2,000; and
> [o]ther general consumer credit transactions such as installment lending, open-end credit, and retail installment credit either excluded or not specifically included in the [MLA].

Id. at 3. To make matters worse, lenders who specialize in loans to military personnel have official sounding names like Military Financial, Just Military Loans, and Patriot Loans. *See* Silver-Greenberg & Eves, *supra* note 206. They like lending to the military because they get paid from the military allotment, which virtually assures payment. Moreover, soldiers have to stay in good financial shape in order to maintain their security clearance, which means lenders have maximum leverage over their borrowers. One lender's website claims: "We know the military because we are former military." *Id.* Lenders also lure customers by offering twenty-five-dollar Starbucks gift cards for referrals and throw parties with free food. *Id.*

212. FELTNER, FOX & UDIS, *supra* note 29, at 3 (citing proposed guidelines for addressing these loopholes, available at http://www.gpo.gov/fdsys/pkg/FR-2013-04-30/pdf/2013-10101.pdf and http://www.gpo.gov/fdsys/pkg/FR-2013-04-30/pdf/2013-10094.pdf).

off financially than many other payday loan customers and that, as a result, non-military families should be equally well protected from predatory lenders.[213] Moreover, Congress can learn from the experience gleaned from the MLA and pass a law that better serves all Americans. Finally, the federal government has the power to enforce a federal usury cap through the Consumer Financial Protection Bureau,[214] whereas most states lack sufficient enforcement power.

VI. CONCLUSION

Congress clearly has the power to set a federal interest rate cap, as it has done in the past with the MLA. We also can learn what not to do from the MLA and from states' attempts to regulate high-cost lending. Congress can adopt neat and trim laws that cap interest on all consumer loans, with no exceptions. There are several ways to accomplish this but the most obvious would be for Congress to simply pass a usury cap similar to an effective state usury cap, but applicable to the entire U.S.

For example, a Massachusetts state statute caps interest, including all fees of any kind, at 20% for all loans, makes it a crime to loan for an interest rate above this amount, and allows the Massachusetts Supreme Court to declare any loan made for an amount greater than this rate to declare the loan void.[215] Arkansas caps interest at 17% through its state constitution.[216] One possibility would be to adopt a federal statute similar to this one:

> (A) Cap on all loans made in the United Sates or to a United States Citizen
>
> > (i) The maximum lawful rate of interest on any contract entered into after the effective date of this law shall not exceed thirty-six percent (36%) per annum, including all interest, costs and fees of any kind, including but not limited to fees for extending credit; fees born-out of default (late fees, overdraft fees, limit fees, etc.); fees defined as a "finance charge;" interest, brokerage, recording fees,

---

213. Johnson, *supra* note 7, at 679.

214. Congress established the CFPB in part to enforce consumer protection laws. *Apply Now for the CFPB Enforcement Team*, CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/jobs/enforcement-attorneys/ (last visited Feb. 6, 2014).

215. MASS. GEN. LAWS ANN. ch. 271, § 49(a) (West, Westlaw current through chapter 38 of the 2nd annual session).

216. ARK. CONST., art. 19, § 13. The rate is actually no more than 5% per annum above the Federal Reserve Discount Rate up to 17% and any loan made in excess of 17% is void as to both the principal and the interest.

> commissions, services, extension of loan, forbearance to enforce payment, and all other sums charged against or paid or to be paid by the borrower for making or securing directly or indirectly the loan or any other fees of any kind (collectively, "Interest").
> (ii) Any contracts having a rate of Interest in excess of that allowed in part (i) above is void as to both unpaid principal and Interest.
>
> (iii) A person who has paid interest in excess of the maximum lawful rate may recover, within the time provided by law, twice the amount of principal and interest paid.
>
> (iv) The provisions of this law are not intended and shall not be deemed to supersede or otherwise invalidate any provisions of state law that sets an interest rate cap that is lower than that set forth here.
>
> (v) The provisions of this law revoke all provisions of State law which establish the maximum rate of interest chargeable in the State that is higher than the rate set forth herein, or that through any other state law, directly or indirectly allow a rate of interest to be changed by any creditor that exceeds the amounts set out herein.[217]

Regardless of the precise method, Congress needs to act based upon broad and deep public support for interest rate caps on both sides of the

217. Another possible solution that already has been proposed is to amend TILA so that no storefront or online payday lender may charge a rate of interest or a fee that exceeds 36%. S. 3452, 112th Cong. (2012), *available at* http://www.gpo.gov/fdsys/pkg/BILLS-112s3452is/pdf/BILLS-112s3452is.pdf. This proposed bill, which has not advanced in Congress yet, broadly defines "fees" and "interests rates" to include "payments compensating creditors for . . . cash advance fees." The bill defines what encompasses fees and interest rates as: 1) fees for extending credit; 2) fees born-out of default (late fees, overdraft fees, limit fees, etc.); 3) fees defined as a "finance charge"; 4) "credit insurance premiums"; and 5) "all charges and costs for ancillary products sold in connection with" the payday loan. *Id.* § 141(b). It also gives individuals rights to sue lenders who violate the law, and to collect the greater of three times the amount of the total accrued debt associated with the violating transaction or $50,000. *Id.* §§ 141(h)-141(i). Violators also would be subject to criminal punishment, including one year in prison and a fine amounting to the greater of three times the amount of the total accrued debt associated with the transaction or $50,000. *Id.* §§ 141(i)(1)-141(i)(2).

political spectrum and the failure of states to uniformly pass such caps, despite widespread public desire for caps. While the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act) has opened the door to federal regulation by giving the Consumer Financial Protection Bureau (CFPB) power to study and regulate payday loans and other fringe lending products,[218] the Dodd Frank Act does not permit the CFPB to set interest rate caps.[219] Thus, while CFPB power may result in meaningful regulation of payday lending, and indeed, payday lending now has the CFPB's attention,[220] only Congress can swiftly stop the waste created by existing patchwork state laws and state enforcement actions.

While setting usury or interest rate caps may at one time have been the purview of states, that time has come and gone. States' attempts to regulate high-cost loans have been costly and inefficient, as have the efforts of state courts to police the loans under unconscionability or other common law theories. If states are unable to pass effective interest rate caps despite the desires of their constituents, it is time for Congress to act.

---

218. *See* Michael B. Mierzewski et al., *The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection as the Primary Regulator of Consumer Financial Products and Services*, 127 BANKING L.J. 722, 723-31 (2010) (discussing the authority and duties of the CFPB).

219. Plunkett & Hurtado, *supra* note 8, at 51; *Payday Loans and Cash Advances*, CONSUMER.GOV, http://www.consumer.gov/ (last visited Feb. 9, 2013).

220. Plunkett & Hurtado, *supra* note 8, at 51. S*ee also* David S. Evans & Joshua D. Wright, *How the Consumer Financial Protection Agency Act of 2009 Would Change the Law and Regulation of Consumer Financial Products*, 2 BLOOMBERG L. REP.: RISK AND COMPLIANCE 1, 3-4 (Oct. 2009), *available at* http://ssrn.com/abstract=1491117 (critiquing the CFPA Act for advocating broad applications without adequate evidentiary basis).