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"Warning: Predatory Lender"—A Proposal for Candid Predatory Small Loan Ordinances

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“Warning: Predatory Lender”—A Proposal for Candid Predatory Small Loan Ordinances

Christopher L. Peterson*

Abstract

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

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I. Introduction

While the heated academic debate over the wisdom of tolerating triple-digit interest rates for consumer finance continues, there is one way in which payday and car-title loans remain relatively uncontroversial. Today, an overwhelming majority of Americans—about three out of four—support traditional usury law prohibiting predatory triple-digit interest rate loans.[1] In every public ballot

1. *See* Center for Responsible Lending, *Congress Should Cap Interest Rates: Survey Confirms Public Support for Cracking Down on High-Cost Lending* (Mar. 2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf ("Three out of four Americans who expressed an opinion think that Congress should cap interest

referendum ever conducted on the subject, Americans have overwhelmingly voted in favor of traditional usury limits on the interest rates of consumer loans.[2] Perhaps surprising in an era of polarized politics, usurious lenders have lost these ballot measures in red, blue, and swing states.[3] These votes against predatory credit

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rates at some level. 72% think that the annual interest rate cap should be no higher than 36% annually."). "Only one quarter of those who expressed an opinion think Congress should not cap interest rates at all." *Id.* The telephone survey reached 1,004 adults in the continental United States. *Id.* CRL weighted the sample by age, sex, geographic region, and race to suggest a 95% chance that the survey results are accurate within 2%. *Id.*; *see also* Center 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"); Kentucky Coalition for Responsible Lending, *Kentucky Voters Support a 36 Percent Rate on Payday Loans, Despite Database and Job Loss Threats* (2010), *available at* http://kyresponsiblelending.files.wordpress.com/2010/01/kcrl_polling_data_fact_sheet_2-7-11.pdf (stating that a survey of "[n]early 400 voters from 179 cities and towns across the Commonwealth" found "73% of voters across the Commonwealth support a 36% APR cap on payday loans").

2. Ballot measures on usury limits have occurred in Arizona, Montana, and Ohio. The public voted overwhelmingly in favor of usury limits in all three states. *See* Tom Jacobson, Op-ed., GREAT FALLS TRIB. (Great Falls, MT), Jan. 6, 2011 ("Ballot Initiative 164, which took effect Jan. 1, capped the annual interest rates on payday and car title loans at 36 percent . . . . The measure passed with 72 percent of the vote statewide. It won in every county and House district . . . ."); Marian McClure & Debbie McCune Davis, Op-ed., *Let's Make Sure the Sun Sets on Arizona Payday Loans*, ARIZONA REPUBLIC, Nov. 21, 2009, at B5 ("60 percent of Arizona voters soundly rejected 400 percent annual interest rates on payday loans, when 1.2 million Arizonans rejected the payday lenders' Proposition 200. The lenders spent more than $14 million trying to fool the people. The voters saw through their scam."); Editorial, *Ohio Voters Prove that a Good Idea Can Beat $22 Million*, AKRON BEACON J. (Ohio), Nov. 6, 2008

> Voters handed the industry a deservedly humiliating defeat, rejecting one of the slickest and most misleading campaigns in the state this election season by a ratio of roughly 2-to-1. The defeat of the lenders is particularly gratifying, as their efforts carefully concealed the industry's goal to regain the license to charge excessive interest rates to borrowers desperate for quick loans.

3. *See* Jacobson, *supra* note 2; McClure & McClure *supra* note 2; *Ohio Voters Prove that a Good Idea Can Beat $22 Million*, *supra* note 2; *see also* Center for Policy Entrepreneurship, *supra* note 1 (stating that a Colorado telephone survey finding "overwhelming support, regardless of political affiliation, region, gender, income, education level, ethnicity and age. 83% of Democrats, 72% of Unaffiliated and 68% of Republicans favored new caps on

pricing are even more emphatic when considered in light of massive industry advertising campaigns that nonetheless utterly failed to persuade voters.[4]

This broad-based support for usury limits is built upon American history, tradition, and culture. For nearly three-hundred years, American states were nearly unanimous in their prohibition of usurious lending through double- or even single-digit interest rate caps.[5] Every signatory to the Declaration of Independence returned to colonies that aggressively capped interest rates.[6] When the "greatest generation" assumed the mantle of public leadership after emerging from the Great Depression and the second World War, all fifty states capped interest rates on small consumer loans with a median limit of 36% per annum.[7] For generations, the Federal Bureau of Investigation used undercover investigations to track down usurious lenders and incarcerate them.[8] The American public's skepticism has at least in part grown out of a moral view, grounded in the prevailing Christian faith of most Americans, that the taking of excessive interest is a grave and punishable sin.[9]

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payday loans").

4. *See, e.g.*, Steve Hoffman, *Battle of the Ballot Issues*, AKRON BEACON J., (Ohio) Apr. 28, 2011, at A6 (stating that voters upheld the Ohio interest rate cap "seeing through an incredible barrage of misleading television ads").

5. RANSOM H. TYLER, A TREATISE ON THE LAW OF USURY, PAWNS OR PLEDGES, AND MARITIME LOANS 50 (1891) (discussing states in early United States history with double- and single-digit interest rate caps).

6. *Id.*

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

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

9. About a dozen Biblical passages suggest that usurious lending, especially to the poor, is a grave sin. For example, the first reference to usury in the Bible states: "If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shalt thou lay upon him usury." *Exodus* 22:25 (King James). The Bible also intimates a harsh punishment for usurers: "Hath given forth upon usury, and hath taken increase: shall he then live? he shall not live: he hath done all these abominations; he shall surely die; his blood shall be upon him." *Ezekiel* 18:13 (King James); *see also Ezekiel* 22:16–22 (King James); *Jeremiah* 15:10 (King James); *John* 2:14–15 (King James); *Leviticus* 25:35–37 (King James); *Luke* 6:33–35 (King James); *Matthew* 5:42

While not all subscribe to this moral value, it is clear that America reached the zenith of its power, wealth, and international prestige following centuries of aggressive enforcement of usury law and a robust thrift ethic.

Nevertheless, in recent decades federal and state usury law has become more lax and less transparent. The Supreme Court's decision in *Marquette National Bank v. First Omaha Service Corp.*[10] adopted a historically controversial interpretation of a Civil War-era banking law that allowed national banks to export high interest rate loans from deregulated states to consumers living in traditionally regulated states.[11] This ignited a race to the bottom in which state legislatures were pressured to raise or eliminate usury limits in order to avoid "discriminating" against local banks.[12] Moreover, high

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(King James); *Nehemiah* 5:1–13 (King James); *Proverbs* 28:6–9 (King James); *Psalm* 15:1, 4–5 (King James); *Luke* 6:31–36 (King James); *John* 2:14–15 (King James). The Biblical condemnation of usurious lenders is closely related to the deep and consistent message of the Bible demanding kind and just treatment of poor and vulnerable members of society. Deuteronomy demands "[t]hou shalt not oppress an hired servant that is poor and needy, whether he be of thy brethren, or of thy strangers that are in thy land within thy gates." *Deuteronomy* 24:14 (King James). The Bible commands Christians to "[e]xecute true judgment, and shew mercy and compassion every man to his brother; [a]nd oppress not the widow, nor the fatherless, the stranger, nor the poor . . . ." *Zechariah* 7:9–10 (King James); *see also* BENJAMIN N. NELSON, THE IDEA OF USURY: FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD (1949) (providing a summary and analysis of post-reformation Christian theology of usury); Charles H. George, *English Calvinist Opinion on Usury, 1600–1640*, 18 J. HIST. IDEAS 455, 455–74 (1957) (same); Steven M. Graves & Christopher L. Peterson, *Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation*, 57 CATH. U. L. REV. 637, 648–55 (2008) (same). *See generally* ODD LANGHOLM, THE ARISTOTELIAN ANALYSIS OF USURY (1985) (providing pre-reformation analysis of Christian usury theology); JOHN T. NOONAN, THE SCHOLASTIC ANALYSIS OF USURY (1957) (same); Brian M. McCall, *Unprofitable Lending: Modern Credit Regulation and the Lost Theory of Usury*, 30 CARDOZO L. REV. 549 (2008) (same).

10. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 308 (1978) (considering "whether Omaha Bank and its Bank Americard program are 'located' in Nebraska and for that reason entitled to charge its Minnesota customers the rate of interest authorized by Nebraska law").

11. *Id.* (stating that "a national bank may charge interest 'on any loan' at the rate allowed by the laws of the State in which the bank is 'located'" (citation omitted)); *see also* James J. White, *The Usury Trompe l'Oeil,* 51 S.C. L. REV. 445, 451–53 (2000) (discussing the *Marquette* decision).

12. *See* Peter A. Alces & Michael M. Greenfield, *They Can Do What!? Limitations on the Use of Change-of-Terms Clauses*, 26 GA. ST. U. L. REV. 1099,

inflation in the late 1970s raised lenders' cost of funds, making profitable consumer lending temporarily more difficult within traditional interest rate caps.[13] This unusual macroeconomic pressure led some states to relax or eliminate their usury limits.[14] More recently, nationally organized, well-funded, and narrowly focused state-by-state lobbying campaigns have persuaded many state legislators serving on key financial services committees to adopt special licensing statutes authorizing non-depositary finance companies to make triple-digit interest rate payday and car-title loans. As a result, usury limits no longer prohibit these loans for banks in all fifty states and for non-depositary lenders in about thirty-five states.

Still, while federal and state law has unraveled, many local leaders around the country continue to ardently support the traditionally restrictive American moral and legal view about usurious lending to families. Responding to the vacuum in usury law, over a hundred different local governments around the country have adopted ordinances attempting to restrict payday and car-title lending.[15] Although this growing trend has generated relatively little national press or scholarly commentary,[16] it appears to reflect

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1128–30 (2010) (stating that in the wake of *Marquette*, legislatures in a number of states "either eliminated or drastically relaxed their usury laws and enacted other provisions that favor credit-card users").

13. *See* PAUL R. BEARES, CONSUMER LENDING 12 (2d ed. 1992) ("[T]he Vietnam War was fueling inflationary pressures which made funds more expensive and harder for banks to attract. *Disintermediation*—the flow of funds out of depository institutions to sources paying higher rates—drained funds available for lending and drove up the cost of funds.").

14. *See id.* ("[P]rofit margins were severely squeezed as a result of a 1979 change in Federal Reserve policy that allowed interest rates to float freely at the same time as the rates banks were allowed to pay for deposits were being deregulated.").

15. Unpublished database on file with author.

16. There are two notable exceptions. *See generally* Kelly Griffith, Linda Hilton & Lynn Drysdale, Controlling the Growth of Payday Lending Through Local Ordinances and Resolutions (Nov. 2007) (unpublished manuscript) ("This guide has been developed to assist community consumer advocates and government officials take action to combat payday lenders in local communities and at state legislatures.") (on file with the Washington and Lee Law Review); Amy Lavine, Zoning Out Payday Loan Stores and Other Alternative Financial Services Providers (July 14, 2011) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1885197 ("This article will

the great majority of the American public that supports the illegality of triple-digit interest rate loans and the long historical tradition of treating payday and car-title lending as a serious civil offense, and in many states, a crime.

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

II. The Law of Predatory Small Loans in Historical Context

All of the thirteen original American colonies aggressively regulated consumer loans with annual interest rate caps of between eight and five percent, with six percent being most typical.[17] European colonists had imported these price limits from England, which at the time capped interest rates with a simple nominal annual rate of five percent.[18] Both American and English usury law grew out of both Protestant and Catholic theology on the moral

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provide an overview of the various approaches that local governments have taken to regulate alternative financial services providers.") (on file with the Washington and Lee Law Review).

17. *See* TYLER, *supra* note 5, at 50–53 (discussing the history of usury laws in early American history); Peterson, *supra* note 7, at 1117–18 (explaining that the thirteen original colonies "unanimously adopted usury laws capping interest rates" and the most common rate was six percent).

18. *See* Act to Reduce the Rate of Interest, 1713, 12 Ann., c. 16 (Eng.) (stating that the interest rate shall not exceed five percent per year).

limits of acceptable lending practices.[19] Early American leaders held usurious lenders in contempt.

At the beginning of the twentieth century, most states in the Union began modifying their interest rate caps to allow more expensive consumer loans. The change reflected the evolving consumer culture of an industrializing America.[20] As more Americans earned their income through relatively stable salaries, rather than seasonal agricultural income, managing a household's needs through the use of moderately priced consumer finance became more culturally acceptable.[21] Throughout most of the twentieth century, "Small Loan Acts" were the primary consumer financial protection law in the country. Most states based their laws on a model statute sponsored by the Russell Sage Foundation, a charitable foundation created by the widow of a railroad baron.[22]

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19. *See* Graves & Peterson, *supra* note 9, at 648–55 (discussing usury laws and the Christian faith). Protestant reformers, such as Martin Luther, believed that interest rates of 5–6% were moral, and that even 8% was permissible in some cases. NORMAN JONES, GOD AND THE MONEYLENDERS 47–48, 77 (1989). Moreover, after centuries of prohibiting any interest whatsoever, Pope Paul II gave his tacit approval to charitable pawnshops to charge a 6% simple nominal annual rate in 1461. *Id.* at 76.

20. *See* LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT 134–35, 143 (1999) (discussing the legalization of small loan lending through the Uniform Small Loan Act and the propaganda about "the productive nature of small loans").

21. *See id.* at 143 (discussing the "success story" which was a tactic used by lenders to promote "the productive nature of small loans").

22. *See* ROGER S. BARRETT, COMPILATION OF CONSUMER FINANCE LAWS AND OF USURY, SALES FINANCE, AND ALLIED LAWS xiii (1952) ("Since 1916, the guide for most consumer finance legislation has been the Draft of the Uniform Small Loan Law recommended by the Russell Sage Foundation when the enactment occurred."). Many of the states that did not use the Russell Sage Foundation model law relied on statutes that legalized "Morris Plan" lending, which facilitated higher real prices by using an add-on interest rate, rather than traditional simple actuarial interest rates. *See* EVANS CLARK, FINANCING THE CONSUMER 68–72 (1930) (discussing the use and development of The Morris Plan); FRED H. CLARKSON ET AL., CONSUMER CREDIT AND ITS USES 32 (Charles O. Hardy ed., 1938) ("The [Morris] plan was that notes be discounted at the maximum contract rate of interest permitted, and then repaid through the purchase of investment certificates on a periodic installment basis."); KATHLEEN E. KEEST, NAT'L CONSUMER LAW CTR., THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES § 2.2.3.1, at 39 (1995) (discussing the plan developed by Arthur Morris "which treated loans as repayable in a single lump sum at the end of the agreed term and computed interest accordingly"). *See generally* PETER

State Small Loan Acts licensed finance companies, authorizing them to charge interest rates ranging from 24%–42% per year, with 36% being typical.[23] Social reformers who lobbied for these rules argued that ordinary citizens ought to have access to credit, and that higher interest rate limits in this range were still within a price zone where borrowers could benefit from the credit and have a reasonable opportunity to repay.[24] These low double-digit interest rate usury limits allowed the development of credit cards and retail installment loan purchasing that became a staple of middle-class America.

By the 1960s, every state in the union had some form of a small loan law on the books.[25] A handful of states had exceptions or ambiguity in their usury limits that allowed higher interest rates by historical standards. But nonetheless, a typical contemporary payday and car-title loan continued to be illegal in every state of the Republic. Although today payday and car-title lenders chafe at the term "predatory lender," with relatively few exceptions, these loans were illegal and often regarded as serious crimes for over three-hundred years of American history.[26] From America's emergence as

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W. HERZOG, THE MORRIS PLAN OF INDUSTRIAL BANKING (1928) (discussing the evolution of The Morris Plan).

23. *See* Peterson, *supra* note 7, at 1120 (stating that states granted "licensed lenders special exemptions to the older usury laws (which generally remained on the books) authorizing interest rates between 2% and 4% per month, or, between 24% and 42% per annum").

24. *See* IRVING S. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 112–29 (1970) (discussing "the remedial loan association movement" and the fight against loan sharks).

25. Peterson, *supra* note 7, at 1138 ("In 1965, every state in the union had a usury limit on consumer loans.").

26. *See* SIDNEY HOMER & RICHARD SYLLA, A HISTORY OF INTEREST RATES 428–29 (3d ed. 1996) (discussing the history of illegal loan interest rates); Peterson, *supra* note 7, at 1119 ("This deep American skepticism of consumer lending encouraged a legal commitment to limited interest rates that continued largely unabated through the end of the nineteenth century."). *See also* Beasley v. Coleman, 180 So. 625, 629 (Fla. 1938) (quashing a habeas corpus petition that challenged conviction for making an approximately 520% interest rate salary loan in violation of Florida's statute imposing up to six months incarceration for usury); Jarvis v. State, 25 S.E.2d 100, 100–01 (Ga. Ct. App. 1943) (upholding criminal conviction for making an approximately 312% annual interest rate salary loan in violation of Georgia's small loan usury limit); Commonwealth v. Morris, 56 N.E. 896, 897 (Mass. 1900) (holding that Massachusetts's criminal penalties of sixty days incarceration for violation of 12% simple nominal annual

an industrial power at the turn of the twentieth century through the apogee of our hegemonic leadership, the premier bastions of consumer protection law were state Small Loan Acts championed by the Russell Sage Foundation.

The United States Supreme Court was the first government institution to meaningfully disrupt the centuries-old tradition of American usury law. In the 1978 case of *Marquette*,[27] the Court confronted for the first time the question of what state usury law applies when a national bank lends money to a consumer across state lines: Should the law of the bank's home state or the law of the consumer's home state apply?[28] Turning to the National Bank Act, a statute adopted in 1864,[29] the Supreme Court concluded that Congress had intended the law of the bank's home state to apply.[30] While seemingly innocuous, this holding gave a handful of rural states the opportunity to deregulate every other state's usury limits

usury limit was constitutional); *Ex parte* Berger, 90 S.W. 759, 760, 763 (Mo. 1905) (holding that Missouri criminal penalties of 30 to 90 days incarceration for violation of 12% annual interest rate limit was constitutional); People v. Lombardo, 460 N.E.2d 1074, 1074–75 (N.Y. 1984) (holding that New York's statute defining lending in excess of 25% annual interest as a class C felony was not unconstitutionally vague). Some states temporarily experimented with eliminating their usury laws for short periods in the nineteenth century. George K. Holmes, *Usury in Law, in Practice and in Psychology*, 7 POL. SCI. Q. 431, 432 (1892) ("In eighteen states and territories that now have usury laws there have been intervals since the first enactment on the subject during which such laws were not in force."). Moreover, in the "wild west" it would often take a few years before newly formed states and territories would adopt usury limits. *Id.* at 436–42 (discussing the history of usury laws "from the earliest times in January 1, 1892").

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

28. *See id.* at 309–13 (considering which state usury law to apply when a national bank lends money to consumers outside of the state in which it is "located").

29. *See* 12 U.S.C. § 85 (2006) (explaining that national banks can charge interest rates according to the laws of the state in which they are located).

30. *See Marquette*, 439 U.S. at 309–13 ("Since Omaha Bank and its Bank Americard program are 'located' in Nebraska, the plain language of § 85 provides that the bank may charge 'on any loan' the rate 'allowed' by the State of Nebraska."); *see also* BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR 725–34 (1957) (detailing the events that led to the enactment of the National Bank Act); KEEST, *supra* note 22, § 3.4.5.1.1 (questioning the historical accuracy of *Marquette*).

with respect to federally chartered banks.[31] Recognizing the opportunity to attract banking jobs to their states, South Dakota and Delaware quickly repealed their interest rate caps and encouraged national banks to open subsidiaries headquartered there to "export" the nonexistence of an interest rate cap to consumers in other states.[32]

For their part, banks chartered by state governments were envious of their national bank competitors' newfound power and immediately began lobbying Congress for equal treatment.[33] While Congress did not explicitly authorize the "exporting" model of deregulation, it did finesse the issue by granting state banks

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31. *See* DEE PRIDGEN, CONSUMER CREDIT AND THE LAW 10-47 to 10-53 (2002) (discussing the *Marquette* decision's effect on usury law); William F. Baxter, *Section 85 of the National Bank Act and Consumer Welfare*, 1995 UTAH L. REV. 1009, 1010–11 (1995) (explaining that after *Marquette* "no state could regulate the rates or services produced by out-of-state national banks, even if the services were purchased by its own citizens"); Robert C. Eager & C.F. Muckenfuss, III, *Federal Preemption and the Challenge to Maintain Balance in the Dual Banking System*, 8 N.C. BANKING INST. 21, 66–67 (2004) ("These so-called 'wild card' statutes vary in their specifics, but generally provide for state banks to be able to match national bank, and in some cases federal thrift, activities."); Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 36–37 (2005) (explaining that the *Marquette* decision "was a starting gun in a corporate race to the bottom that significantly eroded the power of state governments to set meaningful interest rate caps"); Elizabeth R. Schiltz, *The Amazing, Elastic, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518, 619–20 (2004) (stating that after *Marquette* banks can "use the Exportation Doctrine to disregard any interest rate location in any of those other states").

32. *See* White, *supra* note 11, at 447–48 (stating "that this statute would allow a bank in New York to lend from its South Dakota subsidiary to a resident in New York under South Dakota law"). "If the bank comes from a state like Delaware whose laws permit consumer loans without rate or other restrictions, the out-of-state bank can ignore not only the local rates, but also the local market segmentation." *Id.* at 464–65; *see also* Schiltz, *supra* note 31, at 618–20 (stating that "states such as South Dakota and Delaware [have the] incentive to engage in a 'race to the bottom' of consumer credit regulatory schemes, in order to attract consumer lending operations to their states").

33. *See* Howard J. Finkelstein, *Most Favored Lender Status for Insured Banks*, 42 BUS. L. 915, 918 (1987) ("The rationale for the requirement that banks borrowing a rate must also comply with non-rate provisions is simply that Congress is presumed to have intended that a bank borrowing a rate from state law be put on an equal footing with its state-charted competitor.").

whatever power was already held by national banks.[34] As a result, state legislatures became powerless to constrain the interest rates charged by any bank, whether federal or state chartered, that happened to claim its headquarters in South Dakota or Delaware.[35] Seeing no point in punishing their local financial institutions, virtually every other state in the union decided to pass "parity laws" that gave their own local depository institutions the right to charge whatever interest rate South Dakota and Delaware banks could import into their jurisdictions via federal law.[36] The end result was what James White called a *trompe l'oeil*—a grand illusion.[37] Every state in the union, save two, had relatively aggressive usury law on the books, but these laws no longer applied to any bank in the country.

That being said, at the beginning of the 1980s, state usury limits still applied to non-bank lenders. Finance companies, car dealerships, retailers, and even mafia loan sharks were still legally required to comply with the traditional usury limits.[38] Non-depositary finance companies resented the special treatment of banks and in many states began agitating for their own special exceptions to the old small loan laws.[39] High inflation and prevailing

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34. 12 U.S.C. §§ 1463(g), 1831a(b), 1831d(a) (2006); *see also* Interest Charges Under Section 27 of the Federal Deposit Insurance Act, 63 Fed. Reg. 19258–59 (FDIC Apr. 17, 1998) (opinion) (interpreting Section 27 of the Federal Deposit Insurance Act as providing the same interest-rate exporting powers to state-chartered, federally insured banks as Section 85 of the National Bank Act grants to national banks).

35. KEEST, *supra* note 22, at 74–75 (discussing the effect of "sister-state" preemption).

36. *See* Christian Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 368 (1995) (stating that "wild card statutes" can "enable State Banks to enter into derivatives, insurance, and other banking powers currently enjoyed primarily by National Banks"); John J. Schroeder, *"Duel" Banking System? State Bank Parity Laws: An Examination of Regulatory Practice, Constitutional Issues, and Philosophical Questions*, 36 IND. L. REV. 197, 207 (2003) (discussing "parity laws").

37. *See* White, *supra* note 11, at 447–48 ("I argue that the stern statutory restrictions on rates in Minnesota are an illusion whose only current function is to give the appearance that the state is protecting consumers from high rates.").

38. Peterson, *supra* note 7, at 1138–39 (discussing past usury laws and the trend towards relaxing usury laws).

39. *See id.* at 1123 (stating that in the 1980s critics "continue[ed] battering

interest rates in the late 1970s raised lenders' cost of funds, and made these lobbying efforts, at least temporarily, more persuasive.[40] With prevailing prime interest rates in the double-digit range, making profitable consumer loans was difficult under some of the lower traditional interest rate caps. This unusual macroeconomic pressure along with well-funded state-by-state lobbying campaigns persuaded many state legislatures to adopt more expansive usury limit exceptions.[41]

While payday lending had historical forebears both in the United States and around the world, the industry reinvented itself in this period by deferring the deposit of borrowers' personal checks.[42] In a typical transaction, the borrower would write a personal check to the payday lender but date the check for about two weeks in the future.[43] The lender would, in turn, "cash" the check by giving the borrower the face amount of the check less a finance charge. After two weeks went by, the borrower could buy back the check by bringing cash into the payday lender's store, or simply allow the lender to deposit the check. In many states, payday lenders insisted they did not make loans, but rather were simply cashing checks.[44] In other states, payday lenders teamed up with a handful of banks to "rent" the banks' *Marquette* powers.[45] The

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state usury laws" which remained applicable to "nondepository financial institutions").

40. *See* BEARES, *supra* note 13, at 12 (discussing inflation and the consumer movement that was "highly successful in bringing about legislative changes").

41. *See id.* at 12–13 (explaining that "[t]he consumer credit market faced a major trauma in 1980," and "[f]inancial institutions reacted by increasing pressure on state legislators to provide relief from unrealistic usury rate caps").

42. ROBERT MAYER, QUICK CASH 130–34 (2010) (discussing the practice of post-dating checks, a "modern version of the payday loan," which became prevalent in the 1980s).

43. JOHN P. CASKEY, FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR 30 (1994) (explaining that "check cashing outlets" often made payday loans by "cash[ing] a customer's personal check with the understanding that it will not be cleared through the banking system until the customer can deposit his next paycheck, perhaps a week or two hence").

44. *See, e.g.*, Hamilton v. York, 987 F. Supp. 953, 955 (E.D. Ky. 1997) (rejecting a payday lender's argument that "it was not charging interest but only service fees for cashing checks").

45. *See* Michael Bertics, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 133, 146 (2005) ("Non-bank lenders such as payday lenders can take advantage of federal preemption by partnering

payday lender would do the marketing, intake, and collections, but would pay a fee to a bank for permission to nominally make the loan in the name of the bank.[46] Eventually, the federal banking regulators cracked down on these practices by issuing guidance stating that deferred check cashing is a form of lending governed by the Truth in Lending Act[47] and that "charter renting" to avoid usury limits is an unsafe and unsound banking practice.[48] But in the meantime, the payday lending industry had developed a critical mass, with aggressive trade associations and highly effective lobbyists. In many states, payday lenders supported weak legislation that purported to "regulate" payday lending but actually had little substantive content and primarily served to legitimize hitherto illegal or even criminal loans. Indeed with average interest rates of around 400%, payday loans were actually much more expensive than the old mafia loan sharks that typically charged a relatively mild 250%.[49]

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with an out-of-state bank that makes the payday loan and then immediately sells it to the payday lender that is located in the state with the restrictive usury laws."); Elizabeth Willoughby, Recent Development, Bankwest v. Baker*: Is it a Mayday for Payday Lenders in Rent-a-Charter Arrangements?*, 9 N.C. BANKING INST. 269, 273 (2005) ("Many out-of-state payday lenders currently use in-state agents to carry out their business.").

46. *See, e.g.*, Jenkins v. First Am. Cash Advance of Georgia, 400 F.3d 868, 871 (11th Cir. 2007) (explaining an agreement in which First American, a bank located in Georgia, "managed and serviced" payday loans which were approved and funded by First National Bank); People v. Cnty. Bank, 846 N.Y. S.2d 436, 437–38 (N.Y. App. Div. 2007) (explaining agreements wherein County Bank, located in Delaware, agreed to make payday loans which were "market[ed] and service[d]" by Telecash, Inc. and CRA Services Corporation).

47. 12 C.F.R. § 226 (2011).

48. Office of the Comptroller of the Currency, OCC Consent Order No. 2001-104 (Dec. 19, 2001), *available at* http://www.occ.gov/static/enforcement-actions/ea2001-104.pdf; OCC Consent Order No. 2002-93 (October 28, 2002), *available at* http://www.occ.gov/static/enforcement-actions/ea2002-93.pdf; Fed. Deposit Ins. Corp., *Financial Institution Letter, Guidelines for Payday Lending* (Feb. 25, 2005) http://www.fdic.gov/news/news/financial/2005/fil1405.html (last visited Apr. 3, 2012) (on file with the Washington and Lee Law Review); Ben Jackson, *FDIC Actions Indicate Less Tolerant Stance on Payday*, AM. BANKER, Mar. 6, 2006, at 1.

49. *Compare* KEITH ERNST, JOHN FARRIS, AND URIAH KING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING: A REPORT FROM THE CENTER FOR RESPONSIBLE LENDING 3 n.4 (2004), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/crlpaydaylendingstudy.pdf (last visited

With the traditional moral and legal limits crumbling in many states, the payday lending industry exploded. In comparison to the hundreds of years of stable, thrift-oriented American consumer finance, a massive usury industry sprang up almost overnight. In the early 1990s, payday lending was a tiny peripheral component of the financial services industry with only a few hundred locations nationwide.[50] But in the late 1990s and early 2000s, the number of locations around the country rapidly grew. For example, after Mississippi legitimized payday lending by "regulating" it in 1998, the number of payday lenders in the state quickly tripled.[51] North Carolina payday lending outlets roughly quadrupled in four years, growing from 307 in 1997 to 1,204 in 2000.[52] Wyoming payday lenders almost tripled between 1996 and 1997.[53] Payday lending outlets quintupled in Salt Lake City between 1994 and 2000.[54] In

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Apr. 3, 2012) ("[P]lacing the general cost of payday loans between a $15 and $17 fee per $100 loaned for a period of approximately 14 days, amounts equivalent to annual percentage rates of 391% and 443% respectively." (citation omitted)), *with Syndicate Loan-Shark Activities and New York's Usury Statute*, 66 COLUM. L. REV. 167, 167 (1966) ("Exorbitant interest rates, averaging 250 per cent yearly and sometimes reaching as high as 2,000 per cent, are enforced primarily by instilling fear of physical reprisal and, on occasion, by commission of acts of violence.").

50. *See* Fed. Deposit Ins. Corp., *An Update on Emerging Issues in Banking: Payday Lending* (Jan. 29, 2003) http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html (last visited Apr. 3, 2012) ("Industry analysts estimate that the number of payday loan offices nationwide increased from less than 500 in the early 1990's to approximately 12,000 in 2002, with continued growth expected.") (on file with the Washington and Lee Law Review).

51. *See* Jimmie E. Gates, *Check-Cashing Businesses Rolling out the Dough*, CLARION LEDGER (Jackson) Feb. 6, 2005, at B1 ("The state has more than 1,000 check-cashing business[es] today, nearly triple the number in 1998, when the Department of Banking and Consumer Finance began regulating the companies.").

52. OFFICE OF THE COMM'R OF BANKS, REPORT TO THE GENERAL ASSEMBLY ON PAYDAY LENDING 5 (2001).

53. CONSUMER FEDERATION OF AMERICA, THE GROWTH OF LEGAL LOAN SHARKING: A REPORT ON THE PAYDAY LOAN INDUSTRY 3 (1998), *available at* http://www.consumerfed.org/pdfs/The_Growth_of_Legal_Loan_Sharking_1998.pdf.

54. *See* Christopher L. Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 UTAH L. REV. 543, 560–61 ("With only fourteen lenders listed in 1994, the industry appears to have since quintupled its outlets in the Salt Lake area.").

Iowa, payday lender locations grew eightfold in only two years.[55] Nationwide, the number of payday lender locations more than doubled from 10,000 to 22,000 between 2000 and 2004 alone.[56] Today, payday lenders and their secured creditor cousins, the car-title lenders, are no longer fringe businesses. Rather they are a powerful, multi-billion dollar industry that has completely transformed lower- and middle-income American consumer finance.

Despite the usury industry's formidable commitments to campaign finance contributions and government relations, the momentum in continuing legislative battles appears to have died out. In recent years, several states have re-imposed more traditional usury limits. North Carolina led this trend by allowing its payday lending authorization statute to expire under a sunset provision in 2005.[57] Georgia,[58] New Hampshire,[59] Oregon,[60] and the District of Columbia[61] have taken similar measures. In Arkansas, the state

55. JEAN ANN FOX, CONSUMER FED'N OF AM., THE GROWTH OF LEGAL LOAN SHARKING: A REPORT ON THE PAYDAY LOAN INDUSTRY (1998), *available at* http://www.in.gov/dfi/2366.htm ("In two years, Iowa payday lenders increased from eight to sixty-four. Louisiana licenses 345 lenders.").

56. *See* Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* 2 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/ wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf ("The industry is growing very rapidly. Stephens Inc. (2004) estimates that the number of stores rose from 10,000 in 2000 to 22,000 in 2004.").

57. Press Release, N.C. Dep't of Justice, Payday Lending on the Way Out in NC (Mar. 1, 2006), *available at* http://www.ncdoj.gov/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/Payday-lending-on-the-way-out-in-NC.aspx ("The Attorney General's Office and the State Commissioner of Banks have worked together on the issue of lending since state legislators allowed North Carolina's payday lending law to expire after four years on August 31, 2001.").

58. GA. CODE ANN. § 7-3-14 (2011) ("A licensee may charge, contract for, receive, and collect interest at a rate not to exceed 10 percent per annum of the face amount of the contract, whether repayable in one single payment or repayable in monthly or other periodic installments.").

59. N.H. REV. STAT. ANN § 399-A:13 (2011) ("The annual percentage rate on a payday loan shall be no more than 36 percent per year.").

60. OR. REV. STAT. § 725.622 (repealed 2010) (stating that payday lenders may not "[m]ake or renew a payday loan at a rate of interest that exceeds 36 percent per annum, excluding a one-time origination fee for a new loan").

61. D.C. CODE § 28-3301–03 (2011) ("[T]he parties to an instrument in writing for the payment of money at a future time may contract therein for the payment of interest on the principal amount thereof at a rate not exceeding 24%

supreme court used the state's constitutional interest rate cap to overturn legislation authorizing payday lending.[62] In Ohio, Arizona, and Montana the public has voted to reestablish traditional price limits on state ballot measures.[63] At the federal level, Congress created the first national usury limit capping interest rates chargeable to military service members at 36% per year.[64] And, of course, several states, particularly in the northeast, have maintained a steady commitment to traditional usury limits.[65] Still, in many more states, usurious lenders have managed to forestall a return to traditional American law with a variety of cosmetic rules that do not provide meaningful consumer protection. It is these states that have set the stage for a growing trend of municipal and county leadership.

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per annum.").

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

63. *See supra* note 2 and accompanying text (discussing ballot measures on usury limits that have occurred in Ohio, Arizona, and Montana). Despite these referendums, the payday lending industry is actively attempting to circumvent public will in Ohio and Arizona by exploiting loopholes not closed in the precise wording of the ballot measures. *See* Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAP. L. REV. 23, 74–75 (2010) ("Many commentators have noted how adept fringe creditors are at avoiding restrictive regulations. The recent change in the payday lending law in Arizona provides an example.").

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

65. CONN. GEN. STAT. § 36-563 (2004); MD. CODE ANN., COM. LAW § 12-306(a)(2)(i) (West 2011); MASS. GEN. LAWS ch. 140, § 100 (2002); 209 MASS. CODE REGS. 26.01 (LexisNexis 2011); N.J. STAT. ANN. § 2C:21-19 (West 2012); N.Y. PENAL LAW § 190.40 (McKinney 2012); 7 PA. CONS. STAT. ANN. § 6213 (West 2012); VT. STAT. ANN. tit. 9, § 41a(d) (2011).

III. Predatory Is as Predatory Does: Inefficiency in Consumer Finance Markets

The government relations and marketing wings of financial services companies have long talked at cross purposes. When consumer financial services companies speak to legislatures, regulators, and courts, they tend to extol faith in the ability of financial markets to resolve to efficient outcomes. The hallmark of this consumer finance advocacy has always been Adam Smith's "invisible hand" guiding allocation of resources to a collectively optimal outcome through individuals' rational, self-interested decisions. When the sales and marketing wings of financial services firms communicate with prospective borrowers, however, the unmotivated invisible hand is replaced by a calculated effort to persuade and sometimes to confuse or mislead. Consumer finance marketing focuses less on the relationship of supply to demand and more on the formation and manipulation of instincts, wants, and urges as reasons to borrow.[66] While all financial industry lobbyists are economists at heart, the best advertisers are psychologists.

Consistent with this observation, a growing body of psychological evidence suggests that borrowers have behavioral impulses that lead them into making decisions that are counter to their own best interests.[67] The characterization of financial-services

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66. *See* Hooman Estelami, *Cognitive Drivers of Suboptimal Financial Decisions: Implications for Financial Literacy Campaigns,* 13 J. FIN. SERVICES MARKETING 273, 275 (2009) ("The explosive use of short-term lending such as revolving credit products . . . which tap into consumers' desire to gain immediate access to funds, is partially a result of hyperbolic discounting. In recent years, financial services marketers have recognized and effectively capitalized on this phenomenon."); Cornelia Pechmann et al., *Navigating the Central Tensions in Research on At-Risk Consumers: Challenges and Opportunities*, 30 J. PUB. POL'Y & MARKETING 23, 26 (2011) ("The concept of targeting—creating combinations of product, pricing, distribution, and promotional elements to appeal to specific market segments—is central to the practices for-profit and social marketers employ.").

67. *See* CHRISTOPHER L. PETERSON, TAMING THE SHARKS: TOWARDS A CURE FOR THE HIGH COST CREDIT MARKET 156–99 (2004) (discussing behavioural research and consumer finance markets); Oren Bar-Gill, *Seduction by Plastic,* 98 NW. U. L. REV. 1373, 1373–76 (2004) (same); Estelami, *supra* note 66, at 274 (same); Karen E. Francis, *Rollover, Rollover: A Behavioral Law and Economics Analysis of the Payday-Loan Industry,* 88 TEX. L. REV. 611, 627–31 (2010) (same); Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38

markets as driven by rationally comparing the value of one financial service product to others is highly inaccurate. While some borrowers make rational, self-interested, informed decisions on the value of each loan in comparison to its opportunity cost, many do not. At least seven common human psychological patterns create opportunities for predatory lenders to induce contracts that may not be in the best long-term interests of their borrowers.

First, consumers from all walks of life systematically underestimate their exposure to human problems and overestimate their ability to make risk judgments. Because people have difficulty accepting their own vulnerability, most chronically underestimate their chances of heart attacks, asthma, lung cancer, being fired from a job, divorcing within five years after marriage, attempting suicide, and contracting a venereal disease.[68] Workers overestimate their legal protections against employers' arbitrary firings.[69] Even

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AKRON L. REV. 725, 725–39 (2005) (same); Debra Pogrund Star & Jessica M. Choplin, *A Cognitive and Social Psychological Analysis of Disclosure Laws and Call for Mortgage Counseling to Prevent Predatory Lending*, 16 PSYCHOL. PUB. POL'Y & L. 85, 85–131 (2010) (same); Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price,* 65 MD. L. REV. 707, 707–840 (2006) (same).

68. *See, e.g.*, David Dunning et al., *Flawed Self-Assessment: Implications for Health, Education, and the Workplace,* 5 PSYCHOL. SC. PUB. INT. 69, 79–80 (2004) (discussing humans' general over-optimism that negative events will not happen to them). *See generally* SHELLEY E. TAYLOR, POSITIVE ILLUSIONS 8–11 (1989) (discussing the concept of "[t]he self as hero" and explaining the evidence that "adults' positive self-perceptions are unrealistic"); Neil D. Weinstein & Elizabeth Lachendro, *Egocentrism as a Source of Unrealistic Optimism,* 8 PERSONALITY & SOC. PSYCHOL. BULL. 195, 195 (1982) ("People cannot accept their own vulnerability. They expect others to be robbed, injured, or divorced, but never think such misfortunes will happen to them."); Neil D. Weinstein, *Unrealistic Optimism about Susceptibility to Health Problems: Conclusions From a Community-Wide Sample*, J. BEHAV. MED. 481, 481 (1987) (discussing the results of a study on the "tendency to claim that one is less at risk than one's peers"); Neil D. Weinstein, *Why It Won't Happen To Me*, 3 HEALTH PSYCH. 431, 431 (1984) (stating that there is "evidence of unrealistic optimism in risk perceptions").

69. *See* Christine Jolls, *Behavioral Economics Analysis of Redistributive Legal Rules*, 51 VAND. L. REV. 1653, 1659 (1998) ("Almost everyone thinks that his or her chances of having an auto accident, contracting a particular disease, or getting fired from a job are significantly lower than the average person's chances of suffering these misfortunes; estimates range from twenty to eighty percent below the average person's probability."); Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perception of Legal Protection in*

sophisticated managers are prone to treat decisions as unique, generating unreasonably optimistic forecasts by ignoring or minimizing past results.[70] Moreover, even when consumers actually overestimate the probability of emergencies, they typically "think that they personally are peculiarly less susceptible to such events."[71] Consumers tend to be unrealistically optimistic even when negative events have happened to them in the past and when a real, immediate, and visually vivid risk is present.[72]

This natural tendency leaves borrowers systematically vulnerable to exploitative lending. The probability of many of the events that people tend to underestimate, such as sickness, divorce, and job loss, are precisely those events that are the leading causes of insolvency.[73] Moreover, there is robust evidence that borrowers chronically underestimate the cost of credit, even in the face of price disclosures.[74] Credit card borrowers tend to make foolish choices

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an At-Will World, 83 CORNELL L. REV. 105, 106 (1997) ("[W]orkers appear to systematically overestimate the protections afforded by law, believing that they have far greater rights against unjust or arbitrary discharges than they in fact have under an at-will contract.").

70. *See* Marta P. Coelho, *Unrealistic Optimism: Still a Neglected Trait*, 25 J. BUS. & PSYCHOL. 397, 402–04 (2010) (discussing the effects of unrealistic optimism on "economic/managerial activities"); Daniel Kahneman & Dan Lovallo, *Timid Choices and Bold Forecasts: A Cognitive Perspective on Risk Taking*, 39 MGMT. SCI. 17, 17 (1993) (stating that those making decisions often "consider problems as unique" which causes them to ignore past results and make "overly optimistic forecasts").

71. Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175, 1184 (1997).

72. *See* Jerry M. Burger & Michele L. Palmer, *Changes in and Generalization of Unrealistic Optimism Following Experiences with Stressful Events: Reactions to the 1989 California Earthquake*, 18 PERSONALITY & SOC. PSYCHOL. BULL. 39, 39 (1992) (discussing "unrealistic optimism" regarding the probability of being harmed by an earthquake); Peter Harris, Wendy Middleton & Mark Surman, *Give 'em Enough Rope: Perceptions of Health and Safety Risks in Bungee Jumpers,* 15 J. SOC. & CLINICAL PSYCHOL. 68, 68 (1996) (discussing "unrealistic optimism" about the dangers of bungee jumping).

73. *See generally* TERESA A. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE FRAGILE MIDDLE CLASS (2001) (discussing the causes of middle-class bankruptcy).

74. *See* F. THOMAS JUSTER & ROBERT P. SHAY, NAT'L BUREAU OF ECON. RESEARCH, CONSUMER SENSITIVITY TO FINANCE RATES: AN EMPIRICAL AND ANALYTICAL INVESTIGATION 6–46 (1964) (discussing "consumer sensitivity to finance rates"); *see also* NAT'L COMM. ON CONSUMER FIN., CONSUMER CREDIT IN THE UNITED STATES 18–21 (1972) (discussing data that shows "some individual

about contractual terms because they are systematically, unrealistically optimistic about their future card use and personal circumstances.[75] Federal Reserve Board researchers looking at data for the past thirty years in all demographic groups find credit cardholders' opinions "about their own experiences are almost the reverse of their views about consumers' experiences in general, suggesting considerable concern over the behavior of others and possibly a belief that 'I can handle credit cards, but other people cannot.'"[76] A study relying on point-of-sale interviews reports that triple- and quadruple-digit interest-rate payday loan borrowers were "hopelessly optimistic regarding when they expect to be able to repay the loan, particularly at the beginning of the relationship."[77] Many lenders seek to exacerbate this tendency by "shrouding" interest rates—leading borrowers to make life-altering decisions with their biased intuitions, rather than careful financial reflection.[78]

Second, many consumers tend to focus on the present benefits of their actions, while underestimating or ignoring longer-term drawbacks. People have an innate difficulty maintaining self-control in the face of immediate gratification. They tend to prefer a benefit that arrives sooner rather than later, in effect "discounting" the

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consumers have problems repaying their debts"); Jean Kinsey & Ray McAlister, *Consumer Knowledge of the Costs of Open-End Credit*, 15 J. CONSUMER AFFAIRS 249, 250 (1981) (explaining that "[s[tudies have shown that knowledge of the APR is not readily translated into knowledge about the dollar cost of credit"); Victor Stango & Jonathan Zinman, *Fuzzy Math, Disclosure Regulation, and Market Outcomes: Evidence from Truth-in-Lending Reform,* 24 REV. OF FIN. STUDIES 506, 513 (2011) ("We define payment/interest bias as a tendency to underestimate an APR when attempting to calculate it based on other loan terms.").

75. *See* Sha Yang, Livia Markoczy & Min Qi, *Unrealistic Optimism in Consumer Credit Card Adoption*, 28 J. ECON. PSYCHOL. 170, 171 (2007) ("In this paper, we study how such systematic judgment error, the unrealistic optimism (also called wishful thinking) regarding the future usage, impacts consumer decisions on consumer credit card adoption.").

76. Thomas A. Durkin, *Credit Cards: Use and Consumer Attitudes, 1970–2000*, 86 FED. RES. BULL. 623, 628 (2000).

77. Nathalie Martin, *1000% Interest Rates—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 605 (2010).

78. Stango & Zinman, *supra* note 74, at 518 (discussing the practice of many lenders of "shrouding" interest rates).

value of the later reward.[79] While there are large variations in the rates at which people discount the value of future benefits, decades of empirical research confirm a strong present bias among many consumers.[80] This bias creates difficulty for consumers in attempting to order their financial affairs.[81] The abstract nature of financial pricing makes self-control particularly difficult.[82] For example, saving when an asset is highly liquid is hard.[83] Employees are much more likely to accumulate retirement savings when automatically enrolled in 401(k) savings plans—illustrating the power of suggestion and inertia and the relatively minor role the cognitive process of opportunity cost comparison plays in actual financial decision-making.[84] Rather than carefully weighing the serious long-term consequences of their borrowing, many debtors are irrationally "payment-myopic," focusing on whether they can make bi-weekly or monthly payments instead of whether the contract as a whole is a wise decision. Because the negative aspects of debt occur in the future, these outcomes appear less problematic

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79. Richard. H. Thaler, *Some Empirical Evidence on Dynamic Inconsistency,* 8 ECON. LETTERS 201 (1981).

80. *See* Shane Frederick, George Loewenstein & Ted O'Donoghue, *Time Discounting and Time Preference: A Critical Review,* 40 J. ECON. LITERATURE 351, 358 (2002) (discussing the "discounted utility" model of decision making).

81. *See* Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 50, 50 (1991) ("The failure of the competitive model appears to be partly attributable to consumers making credit card choices without taking account of the very high probability that they will pay interest on their outstanding balance." (citation omitted)); Philip Bond, David K. Musto & Bilge Yilmaz, *Predatory Mortgage Lending*, 94 J. FIN. ECON. 412, 413 (2009) (explaining that "existing literature commonly attributes predatory lending to lender fraud and borrower misunderstanding," and one version of this view "presents a model of payday lending in which a lender can, at cost, persuade borrowers to overestimate their future incomes").

82. Adam Gifford, Jr., *Emotion & Self-Control,* 49 J. ECON. BEHAV. & ORGANIZATION 113, 113–14 (2002) (discussing the human problem of self-control).

83. *See* David Laibson, *Golden Eggs and Hyperbolic Discounting,* 112 Q.J. ECON. 443, 446 (1997) (proposing "that financial market innovation reduces welfare by providing 'too much' liquidity").

84. *See* Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149, 1149 (2001) (analyzing the change in employee savings after 401(k) enrollment became automatic).

than they actually will be.[85] Payday and car-title loan borrowers face difficult self-control challenges each time a balloon payment comes due. Because renewing loans is so much easier than retiring the entire debt, borrowers must overcome the temptation to renew their loan each time in order to step off the debt treadmill.[86]

Third, consumer lending markets are likely to be distorted by distressed abbreviated reasoning patterns. Psychologists report that consumers who are suffering from emotional distress, embarrassment, desperation, or fear frequently make poor decisions regarding values and risk.[87] People's impulse control breaks down when they face emotional distress.[88] Most people have limited attention capacity. When they use this attention to cope with a stressor, many consumers use truncated reasoning to quickly escape the stressful situation by seizing on the first minimally acceptable option available to them.[89] Because many consumers are in the market to borrow money precisely to deal with some financial threat, they are likely to lack the attention required to resist the

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85. *See* Gretchen B. Chapman, *Temporal Discounting and Utility for Health and Money*, 22 J. EXPERIMENTAL PSYCHOL.: LEARNING, MEMORY & COGNITION 771, 771 (1996) (explaining that in a study on "health and money intertemporal choices," researchers found "a *delay effect* (smaller discount rates for long delays) and a *magnitude effect* (smaller discount rates for large magnitude outcomes)").

86. Francis, *supra* note 67, at 628 (discussing the rollover temptation inherent in payday loans).

87. *See* Roy F. Baumeister, *Esteem Threat, Self-Regulatory Breakdown, and Emotional Distress as Factors in Self-Defeating Behavior*, 1 REV. GEN. PSYCHOL. 145, 145 (1997) (studying self-defeating behavior); Karen Pezza Leith & Roy F. Baumeister, *Why Do Bad Moods Increase Self-Defeating Behavior? Emotion, Risk Taking, and Self-Regulation*, 71 J. PERSONALITY & SOC. PSYCHOL. 1250, 1250 (1996) ("Our hypothesis is that negative affect causes people to make choices in a way that leads to nonoptimal courses of action: Specifically, one that may indeed hold out the chance of some highly positive outcome but also carries substantial risks or costs.").

88. *See* Diane M. Tice, Ellen Bratslavsky & Roy F. Baumeister, *Emotional Distress Regulation Takes Precedence Over Impulse Control: If You Feel Bad, Do It!*, 80 J. PERSONALITY & SOC. PSYCHOL. 53, 53 (2001) (stating that emotional distress is "detrimental to behavioral self-control").

89. *See* Giora Keinan, *Decision Making Under Stress: Scanning of Alternatives Under Controllable and Uncontrollable Threats*, 52 J. PERSONALITY & SOC. PSYCHOL. 639, 639 (1987) (discussing the effect of stress on decision-making); Willis, *supra* note 67, at 739 (discussing "truncated reasoning" and its effect in stressful situations).

temptation of a temporary financial "quick-fix." Moreover, the most vulnerable loan applicants tend to have problematic credit histories, which lead them to evaluate loan pricing while fearing the embarrassment and rejection. These conditions are likely to inhibit loan applicants' ability to adjust their perceptions of price as they learn about loan terms.[90]

Fourth, even those borrowers who are not shopping for credit under distress have great difficulty understanding and comparing credit prices. Research shows that consumers tend to reduce the amount of effort they expend on making sound decisions when those decisions become more complex—a phenomenon known as information overload.[91] When faced with complex credit price disclosures and boilerplate contracts, borrowers tend to focus on only a few salient aspects of the decision, or even fail to try to understand the information at all.[92] Moreover, when borrowers lack experience or understanding of financial and legal terms of loan contracts, the opportunity cost of comparison shopping from multiple creditors can be quite high, suggesting that careful comparison may not even be rational for borrowers who have literacy and numeracy challenges.[93] The U.S. Department of Education's most recent national survey of adult literacy finds that

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90. *See* Karim S. Kassam, Katrina Koslov & Wendy Berry Mendes, *Decisions Under Distress: Stress Profiles Influence Anchoring and Adjustment,* 20 PSYCHOL. SCI. 1394, 1394 (2009) (studying how people make decisions under stress).

91. *See* Julie R. Agnew & Lisa R. Szykman, *Asset Allocation and Information Overload: The Influence of Information Display, Asset Choice, and Investor Experience*, 6 J. BEHAV. FIN. 57, 57 (2005) ("Research in the decision-making literature suggests that consumers tend to reduce the amount of effort they expend when decisions become more complex." (citations omitted)); John W. Payne & James R. Bettman, *When Time Is Money: Decision Behavior Under Opportunity-Cost Time Pressure*, 66 ORGANIZATIONAL BEHAV. & HUM. DECISION PRESSURE 131, 131 (1996) ("This paper investigates decision processes in environments where there is time stress due to the opportunity cost of delaying decisions.").

92. Jeffrey Davis, *Protection Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consume-Credit Contracts*, 63 VA. L. REV. 841, 842 (1977) (explaining that despite extensive creditor disclosure requirements, studies show that "much remains to be done" to protect consumers).

93. PETERSON, *supra* note 67, at 131 ("The costs of acquiring information must be evaluated relative to the resources of credit shoppers.").

22% of American adults lack even the most basic quantitative literacy skills.[94] These citizens have difficulty performing basic quantitative tasks, such as using or understanding numbers included in print materials. Thus, they are systematically vulnerable to deceptive and misleading credit pricing tactics.[95] Indeed, at least one analysis of the subprime mortgage crisis reports a strong correlation between numerical ability and foreclosure.[96]

Fifth, the language, terminology, and marketing practices used to present credit contracts can strongly influence how borrowers perceive prices. Compelling evidence suggests that the way pricing and risk information is presented, or "framed," can consistently influence human choices.[97] For example, people are more averse to medical treatments when identical risk data are framed as a mortality rate than when framed as a survival rate.[98] Consumers treat identical investment risks differently depending on whether

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94. *See* UNITED STATES DEPARTMENT OF EDUCATION, NATIONAL ASSESSMENT OF ADULT LITERACY (2003), *available at* http://nces.ed.gov/naal.

95. *See* Gerard Caprio, Jr., *The Great Innumeracy Epidemic*, 11 FIN. REGULATOR 37, 37 (2007) (discussing the effect of illiteracy on individuals' financial decisions); Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233 260–62 (2002) ("[R]esearch suggests that disclosure statements accompanying consumer contracts, however well designed, may not be able to aid most consumers in understanding the terms of their agreements.").

96. Kristopher Gerardi, Lorenz Goette & Stephan Meier, *Financial Literacy and Subprime Mortgage Delinquency: Evidence from a Survey Matched to Administrative Data* (Fed. Reserve Bank of Atlanta, Working Paper No. 2010-10, 2010).

97. *See* Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCI. 453, 453 (1981) ("Because of imperfections of human perception and decision, however, changes of perspective often reverse the relative apparent size of objects and the relative desirability of options.").

98. *See* Barbara J. McNeil, Stephen G. Pauker, Harold C. Sox, Jr. & Amos Tversky, *On the Elicitation of Preferences for Alternative Therapies*, 306 NEW ENG. J. MED. 1259, 1260 (1982) ("Recent work by cognitive psychologists on the framing of decision problems indicates that the characterization of outcomes in terms of the probability of survival rather than the probability of death can have a substantial effect on people's preferences."); Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. BUS. S251, S254–55 (1986) (explaining a study where "[t]he same statistics were presented to some respondents in terms of mortality rates and to others in terms of survival rates" and respondents were asked which treatment they would prefer).

they are presented as a gamble or insurance.[99] These patterns exist and can be manipulated in consumer financial services markets. For example, "[i]ndividuals will perceive a penalty for using credit cards as a loss and a bonus for using cash as a gain; this will lead individuals to use cash if and only if the 'penalty' tack is taken, although the two situations are, from an economic and end-state perspective, identical."[100] Payday lenders prefer to describe their loan prices as a percentage of the loan principal, rather than with a simple nominal annual interest rate because, for example, borrowers are likely to perceive a two-week loan with a price of 15% of the amount financed as less expensive than the same loan with a 391% simple nominal annual interest rate—even though these prices are in fact identical.[101]

Moreover, people tend to rely too heavily on first impressions when assessing risk and value.[102] This is to say, people tend to "anchor" on early estimates and fail to sufficiently revise their perception of price or risk when further information comes to light.[103] For example, research suggests anchoring on the early

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99. *See* John C. Hershey & Paul J. H. Schoemaker, *Risk Taking and Problem Context in the Domain of Losses: An Expected Utility Analysis,* 47 J. RISK & INS. 111, 111 (1980) (examining "the extent to which . . . risk preferences are influenced by problem context").

100. Edward J. McCaffery, Daniel J. Kahneman & Matthew L. Spitzer, *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards, in* BEHAV. LAW & ECON. 259, 262 (Cass R. Sunstein ed., 2000).

101. Peterson, *supra* note 7, at 1154 (explaining that although "there is no objective mathematical difference between a typical payday loan limited in price with a 391% annual percentage rate cap and one limited with a cap of 15% of the loan principal," consumers often perceive the annual percentage cap as higher).

102. *See* Matthew Rabin & Joel L. Schrag, *First Impressions Matter: A Model of Confirmatory Bias*, 114 Q.J. ECON. 37, 37 (1999) ("Psychological research indicates that people have a cognitive bias that leads them to misinterpret new information as supporting previously held hypotheses.").

103. *See, e.g.*, Hillel J. Einhorn & Robin M. Hogarth, *Decision Making Under Ambiguity, in* RATIONAL CHOICE 41, 46–51 (Robin M. Hogarth & Melvin W. Reder eds., 1987) (explaining the "anchoring-and-adjustment strategy in which an initial probability is used as the anchor (or starting point) and adjustments are made for ambiguity"); Robin M. Hogarth, *Beyond Discrete Biases: Functional and Dysfunctional Aspects of Judgmental Heuristics*, 90 PSYCHOL. BULL. 197, 206 (1981) (explaining that the "adjustment and anchoring heuristic" is characterized by "[s]ubjects [who] are assumed to fix (i.e., anchor) on the probability of one elementary event but fail to adjust sufficiently for the other

estimate of the value of a lawsuit tends to disrupt later settlement negotiation.[104] Even accountants conducting audits anchor on early estimates and insufficiently correct their judgments.[105] Marketing professionals have absorbed these lessons and systematically design sales tactics to exploit this pattern in judgment making.[106]

Sixth, an impressive body of empirical research indicates most people are irrationally averse to losses. The classical economic account of rational decision-making suggests individuals should value their out-of-pocket costs in the same manner as they value forgone opportunities. This is to say, people should not be more displeased with losses than they are pleased with equivalent gains. But, some data indicate consumers are actually roughly twice as displeased with losses as they are pleased with equivalent gains.[107] A related tendency makes consumers willing to assume an

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events" (citation omitted)); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases,* 185 SCI. 1124, 1128–30 (1974) (discussing "adjustment and anchoring" which occurs when "people make estimates by starting from an initial value that is adjusted to yield the final answer"); Richard H. Thaler, *The Psychology of Choice and the Assumptions of Economics*, *in* QUASI RATIONAL ECONOMICS 137, 152 (1991) ("[B]ecause of the mind's limited information processing and storage capabilities, humans must use simple rules of thumb and heuristics to help make decisions and solve problems.").

104. *See* Daniel Kahneman & Amos Tversky, *Conflict Resolution: A Cognitive Perspective*, *in* BARRIERS TO CONFLICT RESOLUTION 44, 54–56 (Kenneth J. Arrow et al. eds., 1995) (explaining the role of initial reference points in settlement negotiations).

105. *See* William R. Kinney Jr. & Wilfred C. Uecker, *Mitigating the Consequences of Anchoring in Auditor Judgments*, 57 ACCT. REV. 55, 55 (1982) ("The present study reports the results of an experiment involving two audit tasks in which the judgments of audit seniors are biased consistent with their use of the anchoring and adjustment heuristic." (citation omitted)).

106. *See* Estelami, *supra* note 66, at 279 (discussing areas that financial programs should address); Brian Wansink, Robert J. Kent & Stephen J. Hoch, *An Anchoring and Adjustment Model of Purchase Quantity Decisions*, 35 J. MARKETING RES. 71, 72 (1998) (suggesting "that a simple anchoring and adjustment judgment process adequately describes how consumers make [purchasing] decisions" and "that marketers can influence quantity decisions through anchors provided at the point of purchase"); Star & Choplin, *supra* note 67, at 97 (discussing "anchoring" as one type of "social psychological phenomen[on] that prevent[s] [creditors'] disclosures from being effective").

107. *See* PETERSON, *supra* note 67, at 175 ("Some data indicates consumers are actually roughly twice as displeased with losses as they are pleased with equivalent gains.").

objectively inordinate amount of risk when facing the loss of something they already possess.[108] For example, people who have owned antique furniture or vintage wine for a long period of time commonly refuse to sell their possessions for prices far greater than market value—even though they could buy a replacement and pocket the difference.[109] Some economists explain this is because the owners have "endowed" their possessions with personal value.[110] Similarly, many firms sell products with "a thirty day trial offer" with a "no questions money back guarantee," where the consumer does not have to pay until after the temporary period expires. The seller realizes the buyer will pay a higher price after endowing the product with personal value, or, stated differently, the buyer will pay more to avoid losing a product they already have. By holding on too tightly to the things they possess, many consumers exhibit a classically irrational bias for preserving the status quo.[111] In the high-cost credit market, lenders have learned to exploit loss aversion. For example, car-title lenders, also called "auto pawn" companies, often extract more payment out of consumers who do not want to lose their cars than the cars themselves are worth.[112] Similarly, homeowners who have fallen behind on mortgage

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108. *See id.* ("A related tendency makes consumers willing to assume an objectively inordinate amount of risk when facing the loss of something they already possess.").

109. *See id.* at 175–76 ("For example, people who have owned antique furniture or vintage wine for a significant period of time commonly refuse to sell their possessions for prices far greater than market value— even though they could buy a replacement and pocket the difference.").

110. Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1326 (1990) (discussing the "endowment effect" on individuals which occurs when they own a good for a certain period of time); Cynthia E. Devers, Robert M. Wiseman & R. Michael Holmes, *The Effects of Endowment and Loss Aversion in Managerial Stock Option Valuation*, 50 ACAD. MGMT. J. 191, 194 (2007) (discussing the "status quo bias" which is "a preference for the current state that biases the economist against both buying and selling" a good that he has owned for some time).

111. *See generally* Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. ECON. PERSPS. 193 (1991).

112. *See* PETERSON, *supra* note 67, at 175 ("A related tendency makes consumers willing to assume an objectively inordinate amount of risk when facing the loss of something they already possess.").

payments will often agree to onerous terms refinancing their homes in order to avoid foreclosure.

Finally, credit contracts generally, and high-interest consumer financial products in particular, have the potential to exacerbate the harm of addictive and compulsive consumer behavior. A reality in modern life is that many Americans suffer from addictions and compulsive behavior. The problems of alcoholism, pathological gambling, and compulsive shopping all have the potential to be negatively interrelated with consumer credit.[113] Addicted and compulsive consumers can use exhaustion of their financial resources as a self-control mechanism—terminating a gambling binge, for example, once the consumer has no more money left.[114] Consumer credit, particularly when offered on predatory terms, can create the constant possibility of relapse. Market forces do not protect this large and vulnerable segment of the population from onerous debt problems.

Collectively, these behavioral patterns suggest a very different picture of the free market than the portrait painted by advocates of weak law. Marketing academics have long recognized that aggressive advertisers can leverage these heterogeneously distributed behavioral patterns by targeting inefficient consumers.[115] Unlike the homogeneous pricing of most goods,

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113. *See, e.g.*, Ronald J. Faber & Thomas C. O'Guinn, *Compulsive Consumption and Credit Abuse,* 11 J. CONSUMER POL'Y 97, 99 (1988) (explaining that "compulsive consumption" is a "psychological factor" that likely contributes to excessive debt); Henry R. Lesieur, *Compulsive Gambling*, 29 SOCIETY 43, 45 (1992) (discussing debt caused by gambling addictions); Howard Tokunaga, *The Use and Abuse of Consumer Credit: Application of Psychological Theory and Research*, 14 J. ECON. PSYCHOL. 285, 287 (1993) (explaining that "compulsive buying," which is defined as "a chronic inability to refrain from spending money" often leads to "severe financial and psychological hardship" (citation omitted)).

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

115. Terri L. Rittenburg & Madhavan Parthasarathy, *Ethical Implications of Target Market Selection*, 17 J. MACROMARKETING 49 (1997) ("One implication may be another form of market *segmentation*, or an additional dimension for

consumer loans are underwritten to the needs and abilities of individual borrowers, giving lenders the opportunity to heterogeneously price loans based on the inabilities and misunderstanding of loan applicants. In many markets, shoppers discern pricing and quality. But in consumer finance markets, lenders can segment the market based on consumer vulnerability, rather than on product quality.[116]

In addition to behavioral research, some scholars have attempted to explore the welfare effects of small, high-cost consumer loans.[117] However, this research is notoriously difficult for a variety of reasons. First, it is difficult for these studies to account for all borrowers. Borrowers are often embarrassed and confused regarding their financial circumstances and are reluctant or unable to self-report their difficulties.[118] Those who use small, high-cost consumer loans may change jobs and relocate more often than more affluent families, which introduces difficulties with tracking borrowers long-term.[119] Payday and car-title lenders typically do not report their borrowers' repayment patterns with the national credit bureaus, and many borrowers in this market are not plugged into

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identifying subsegments: taking product category and vulnerability of consumers into consideration. This method may be useful in marketing, not only socially desirable products, but also potentially harmful products.").

116. *See* Oren Bar-Gill, *The Behavioral Economics of Consumer Contracts*, 92 MINN. L. REV. 749, 767 n.78 (2008) ("If market segmentation based on the level or type of misperception is possible, then sellers will design their products and pricing schemes in response to consumer misperception even when the average bias is zero."); KATHLEEN C. ENGEL & PATRICIA A. MCCOY, THE SUBPRIME VIRUS: RECKLESS CREDIT, REGULATORY FAILURE, AND NEXT STEPS 22 (2011) ("[L]endors could 'prescreen for vulnerability,' picking out people they could most easily dupe." (citations omitted)).

117. *See infra* notes 127–52 and accompanying text.

118. *See* Christopher L. Peterson, *Truth, Understanding, and High-Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 807. 897 (2003) ("Sharing word of mouth criticism of high-cost lenders often means exposing embarrassing financial problems." (citations omitted)).

119. *Cf. Payday Loans, Inc.: Short on Credit, Long on Debt*, CENTER FOR RESPONSIBLE LENDING 3–4 (Mar. 31, 2011) [hereinafter *Payday Loans, Inc.*], *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf (acknowledging the lack of long-term studies of payday-loan borrowers and providing data from a two-year study of borrowers in Oklahoma—one of only eleven states with a consolidated database tracking system that allows this long-term research).

the mainstream economy in the same way as more affluent people.[120]

Second, it is challenging for studies to separate the welfare effects of small, high-cost consumer loans with the effects of other financial stressors and demographic forces in borrowers' lives. Many studies do not account for local, regional, and national changes in labor markets; the effects of the housing bubble and crisis over the past fifteen years; and the complex dynamics of other social forces that affect low- and moderate-income communities, such as crime, drug addiction, divorce rates, the number of dependents per wage earner, educational levels, educational quality, military service, and racial discrimination.[121] Factors such as the fluctuating cost of gasoline, the rising price of health care, and the declining access to health insurance—all of which exist across complex temporal, spatial, legal, and social patterns—profoundly affect many families. Studies of payday and car-title lending must also contend with causal noise created by other forms of credit, asset accumulation, and asset protection, including credit cards, bounce-protection plans, pawnshops, installment loans, negotiating delayed payments with creditors, credit union programs, peer-to-peer online lending, family support networks, saving accounts, and the ability of borrowers to evade creditor collection remedies.

Third, many studies fail to account for the differences in unsecured creditor remedies in various legal jurisdictions. The growing use of payday loans offered—both legally and illegally—over the Internet distorts the effect of laws regulating small-loan markets.[122] Even in states where the state government is

120. *See* Katy Jacob, *Reaching Deeper: Using Alternative Data Sources to Increase the Efficacy of Credit Scoring*, THE CTR. FOR FIN. SERVS. INNOVATION 6 (Mar. 2006), *available at* http://cfsinnovation.com/system/files/imported/managed_documents/alternative_credit_scoring.pdf ("[T]raditional credit reporting agencies do not track or score payday loan payments, and payday lenders tend to report only poor payment history . . . . As a result, payday loan users have difficulty graduating to more mainstream and less expensive credit.").

121. *See, e.g.*, *Payday Loans, Inc.*, *supra* note 119, at 9 (finding, without controlling for outside factors, that borrowers' debts typically increase over time).

122. *See* Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 869 n.53 (2007) (finding only three of eight online payday lenders that identify which state's law applies); Jean Ann Fox & Anna Petrini, *Internet*

attempting to collect useful data, many members of the small-loan industry actively evade these reporting requirements as well as the consumer protection laws that generally go along with them.[123] The civil justice system does not generally provide useful information about this market because the size of the loans often makes litigation cost-prohibitive from borrowers' perspectives.[124] Many payday and car-title lenders have arbitration agreements that force borrowers into private dispute resolution.[125] And most of all, the people who could supply the information to overcome these hurdles—payday and car-title lenders themselves—generally refuse to release their loan data.[126]

Nevertheless, in recent years researchers have released a growing number of papers, some of which have been published, that purport to show both beneficial and harmful effects of payday lending.[127] While a complete exposition of this growing body of

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Payday Lending: How High-Priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections, CONSUMER FED'N OF AM. 4, 7–10 (Nov. 30, 2004), *available at* http://www.consumerfed.org/pdfs/Internet_Payday_Lending113004.PDF (providing data about online lenders that evade state laws).

123. *See, e.g.*, Jean Ann Fox, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury*, CONSUMER FED'N OF AM. 7–9, 13–14, 17, 23 (Mar. 30, 2004), *available at* http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/pdlrentabankreport.pdf (detailing various ways in which payday lenders evade consumer protection laws and reporting requirements).

124. *See, e.g.*, Diane Hellwig, Note, *Exposing the Loansharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1587 (2005) ("Consumer loans involve such small amounts that bringing these cases on an individual basis is cost prohibitive.").

125. *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 48–49 (2002) (providing data about payday lender arbitration clauses).

126. *See, e.g.*, *id.* at 40–47 (providing data on Ohio payday lenders who refuse to disclose loan data).

127. *See generally* Sumit Agarwal, Paige Marta Skiba & Jeremy Tobacman, *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?,* (Nat'l Bureau of Econ. Research, Working Paper No. 14659, Jan. 2009), *available at* http://www.nber.org/papers/w14659.pdf (analyzing "household choices between liabilities [on balance sheets] and . . . the informational content of prime and subprime credit scores in the consumer credit market"); Dennis Campbell, Francisco de Asis Martinez-Jerez & Peter Tufano, Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures,

literature is beyond the scope of this Article, a few examples are helpful. For instance, the payday lending industry has widely distributed an unpublished working paper written by Donald Morgan and Michael Strain.[128] Morgan and Strain conclude that the reimposition of traditional interest rate limits in North Carolina and

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(Dec. 3, 2008) (working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873 (analyzing the determinants of involuntary checking and debit account closures); Scott E. Carrell & Jonathan Zinman, *In Harm's Way? Payday Loan Access and Military Personnel Performance* (Fed. Reserve Bank of Phila., Working Paper No. 08-18, Aug. 1, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id =1269414 (finding that "payday loan access causes financial distress and severe misbehavior" for some Air Force personnel); Susan Payne Carter, Paige Marta Skiba & Jeremy Tobacman, *Pecuniary Mistakes? Payday Borrowing by Credit Union Members,* (Pension Research Council, Working Paper No. 2010-32, Nov. 11, 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id =1707657 (examining patterns of a credit union member's financial choices, including a high level of payday borrowing); Adair Morse, *Payday Lenders: Heroes or Villains,* 102 J. FIN. ECON. 28 (2011), *available at* http://www.sciencedirect.com/science/article/pii/S0304405X11000870 (discussing the effect of the availability of payday loans on the welfare of communities after natural disasters); Paige Marta Skiba & Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* (Vanderbilt Law & Econ., Research Paper No. 11-13, Nov. 9, 2009), *available at* http://www.law.yale.edu/documents/pdf/LEO/J.Tobacman.pdf (estimating "the causal impact of access to payday loans on bankruptcy filings"); Donald P. Morgan & Michael R. Strain, *Payday Holiday: Households Fare After Payday Credit Bans* (Fed. Reserve Bank of N.Y., Staff Report No. 309, 2008) [hereinafter Morgan & Strain, *Payday Holiday*], *available at* http://www.newyorkfed.org/research/staff_reports/sr309.pdf (offering data to contradict negative critiques of payday lending); Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic Borrowing*, 17 ECON. DEV. Q. 8 (2003), *available at* http://www.ccc.unc.edu/documents/CC_Payday_lending.2.2003.pdf (exploring the rapidly growing supply and demand for payday credit and how it leads to chronic borrowers); Petru S. Stoianovici & Michael T. Maloney, Restrictions on Credit: A Public Policy Analysis of Payday Lending (Oct. 28, 2008) (working paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1291278 (finding "no empirical evidence that payday lending leads to more bankruptcy filings"); Jonathan Zinman, *Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap*, 34 J. BANKING & FIN. 546 (2010), *available at* http://www.dartmouth.edu/~jzinman/Papers/Zinman_RestrictingAccess_jbf_forth.pdf (arguing that restricting access to expensive credit harms consumers, on average, more than it helps them).

128. *See, e.g.*, Donald Rieck, *"Predatory Reporting" on Payday Lending*, ADVANCE AMERICA CASH ADVANCE (July 18, 2008), http://www.advanceamerica.net/about-us/media-details/152 (last visited Apr. 3, 2012) (referencing the Morgan and Strain paper) (on file with the Washington and Lee Law Review); Morgan & Strain, *Payday Holiday*, *supra* note 127 (offering data to contradict negative critiques of payday lending).

Georgia led to greater rates of bounced checks than the national average, more complaints to the Federal Trade Commission (FTC) about lenders and debt collectors, and Chapter 7 bankruptcy filing at rates greater than the national average.[129] Consumer advocates at the Center for Responsible Lending, however, aggressively challenged the study's methods.[130] With respect to the bounced-check claim, Morgan and Strain used regional data from the Federal Reserve's regional check-processing centers (CPCs) as proxies for North Carolina's and Georgia's bounced-check rates.[131] But each of these regional CPCs also processes returned checks from other states, including states with legal and rapidly growing payday-lending industries during the study period, and the data do not purely represent North Carolina's or Georgia's returned-check rates.[132] Moreover, the study did not control for the other independent, regionally related factors that could have accounted for a very small reported increase in bounced checks across the region including, for example, Hurricane Katrina.[133] With respect to FTC complaints, the Center for Responsible Lending pointed out that the study did not account for the generally rising FTC complaint rates prior to the study period nor the fact that complaint rates are likely driven by the growing unrelated problem of identity theft.[134] Even more problematic was the study's useless bankruptcy data, which did not control for other independent variables that "greatly influence a person's chances of filing for bankruptcy protection, including health insurance coverage, foreclosures,

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129. For their conclusion, see Morgan & Strain, *Payday Holiday*, *supra* note 127, at 26.

130. *See CRL Critique of "Payday Holiday: How Households Fare After Payday Credit Bans" by Donald P. Morgan and Michael R. Strain*, CENTER FOR RESPONSIBLE LENDING 1–4 (Jan. 2008) [hereinafter *CRL Critique*], *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/states/crl-morgan-critique-12-10.pdf (arguing that "Morgan and Strain's data and research methods are not adequate to support [their] findings or overall conclusion").

131. *See* Morgan & Strain, *Payday Holiday*, *supra* note 127, at 3 (discussing use of CPCs); *CRL Critique*, *supra* note 130, at 2 (describing CPCs as proxies).

132. *CRL Critique, supra* note 130, at 2.

133. *See id.* (stating the possible effects of factors such as Hurricane Katrina).

134. *Id.* at 3.

divorce rates, [and] demographic factors such as income."[135] Despite all these shortcomings (as well as the authors' disclaimer that their findings were "preliminary" and shared "solely to stimulate discussion"),[136] the Morgan and Strain paper remains notable because industry lobbyists have so frequently supplied the piece to state legislatures and quoted it in the press that it remains the most prominently discussed proxy welfare variable study to date.[137]

In contrast, Brian Melzer's more recent study published in the *Quarterly Journal of Economics* measures the effects of payday loan availability on borrower well-being.[138] Using a clever study design, Melzer focused on families from states that effectively banned payday lending, but the families nonetheless had access to payday loans because they lived just over the border of a state that allowed payday lending.[139] This allowed Melzer to compare families that had cross-border access to payday loans with similar families that did not have access to payday loans.[140] Melzer measured borrower well-being with self-reported variables, including postponed medical care, postponed dental care, and postponed prescription drug purchases; difficulty paying mortgage, rent, or utility bills; moving out of one's home due to financial difficulties; inability to afford meals; and going without telephone service.[141] Melzer conducted a variety of different regressions to discover whether access to payday loans caused an increase in hardship, including one focusing on differences in payday loan access over time and another focusing on different income groups—both of which confirmed his baseline

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135. *Id.*

136. Morgan & Strain, *Payday Holiday*, *supra* note 127, at cover page.

137. *See, e.g.*, Rieck, *supra* note 128 (referencing the Morgan and Strain paper); John Payne, *Good Intentions Don't Always Make Good Policy*, THE JOPLIN GLOBE (June 27, 2010), http://www.joplinglobe.com/editorial/x1617565386/John-Payne-guest-columnist-Good-intentions-don-t-always-make-good-policy (last visited Apr. 3, 2012) (referencing the Morgan and Strain paper) (on file with the Washington and Lee Law Review).

138. *See* Brian T. Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, 126 Q.J. ECON. 517, 517 (2011), *available at* http://qje.oxfordjournals.org/content/126/1/517.full.pdf (estimating the "real effects of credit access among low-income households").

139. *Id.* at 518–19.

140. *Id.*

141. *Id.* at 525–26.

results "that payday credit access is associated with greater hardship among families with $15,000 to $50,000 of annual income."[142] Melzer found evidence that families with access to payday loans were more likely to have difficulty paying their bills, to have to skip meals, and to live without access to a telephone.[143] His results suggest, for example, that the likelihood of reporting difficulty paying bills increases by 25% for families with access to payday loans.[144] Melzer also found that families with access to payday loans were more likely to suffer health-related hardship by postponing medical care, dental care, and prescription drug purchases.[145]

Similarly, Kurbin, Squires, and Graves recently published a study in the *Journal of Criminology and Public Policy* showing that a greater density of payday-lending locations causes an increase in local crime rates.[146] The study compared payday-lender locations to reported violent- and property-crime rates in census tracts within the Seattle area, regressing for a broad array of independent variables that included the percentage of secondary sector low-wage jobs, the jobless rate, the percentage of employed people working as professionals or managers, the percentage of high school graduates, the poverty rate, the percentage of black people, the percentage of young males, the residential instability index, the percentage of

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142. *Id.* at 534, 537–47. In addition to his regressions, Melzer also conducted two falsification exercises to test whether his results held true in income groups that do not commonly use payday loans. Melzer's falsification tests showed that geographic access to payday loans had no effect on individuals who do not use payday loans because they either had such minimal income they cannot qualify for payday loans or because their income was so high they have access to cheaper forms of credit. *Id.* at 534–37. These tests further strengthen Melzer's case that his regressions capture a causal effect of payday-loan access.

143. *See id.* at 532–33 (indicating a strong increase in families' likelihood to have difficulty paying bills, and a mild increase in likelihood to cut meals or to live without a telephone, when the families have access to payday loans).

144. *Id.* at 534.

145. *Id.* at 550.

146. Charis E. Kubrin, Gregory D. Squires, Steven M. Graves & Graham C. Ousey, *Does Fringe Banking Exacerbate Neighborhood Crime Rates? Investigating the Social Ecology of Payday Lending,* 10 CRIMINOLOGY & PUB. POL'Y 437, 457 (2011), *available at* http://onlinelibrary.wiley.com/doi/10.1111/j.1745-9133.2011.00719.x/pdf (studying the link between payday lending sites and neighborhood crime rates).

female-headed households, and population—all of which have been shown to be related to community crime rates.[147] This study attempted to account for multicollinearity between the independent variables, spatial autocorrelation, and endogeneity between crime and payday lender density. In three different regression models, the study found that "payday lending is significantly associated with both violent and property crime rates. This relationship holds even after controlling for a host of factors typically associated with neighborhood crime rates."[148] The study asserts that payday lending imposes "broader community costs . . . that *all* residents pay when they reside in neighborhoods with a concentration of payday lenders."[149] Taking one specific example of just such a community cost, the study points out that much research has shown a strong relationship between crime rates and property value,[150] which suggests that payday lending locations may depress property values.[151] This claim will not surprise the many local government leaders around the country who have frequently asserted the same point.[152]

While the social science is by no means unanimous, the best evidence suggests that small, high-cost loans are harmful to

147. *Id.* at 444–46.

148. *Id.* at 456.

149. *Id.* at 457.

150. *Id.* at 458 (citing David R. Bowes & Keith R. Ihlanfeldt, *Identifying the Effects of Rail Transit Stations on Residential Property Values*, 50 J. URBAN ECON. 1 (2001); Steve Gibbons, *The Costs of Urban Property Crime*, 114 ECON. J. F441 (2004); Richard H. Thaler, *A Note on the Value of Crime Control: Evidence from the Property Market*, 5 J. URBAN ECON. 137 (1978)).

151. *Id.*

152. *See, e.g.*, Joel Davies, Editorial, *Some Firms Hurt Neighborhoods*, OMAHA WORLD-HERALD, Feb. 4, 2009, at 07B, *available at* http://docs.newsbank.com/s/InfoWeb/aggdocs/AWNB/12DC0E8731B34440/D0C690B70D3F4E599FDEF466B2BF232D?p_multi=OWHB&s_lang=en-US ("When zoning laws enable predatory businesses to fill in the empty storefronts of our neighborhoods, we see increased crime, decreased property values and neighbors afraid to walk outside their doors after dark. Predatory businesses[,] like payday loan operations[,] . . . prey on those whose ties to society already are weakened."); Annysa Johnson, *Payday Loan Stores in Crosshairs: Tosa Imposes One-Year Moratorium While It Studies Permanent Restrictions*, MILWAUKEE J. SENTINEL, Sept. 21, 2006, at B6 ("Wauwatosa's moratorium is in response to neighbors' complaints that the . . . [payday loan] store would attract crime and lower property values.").

borrowers and their communities on balance.[153] Given the complexity of the research, local government leaders can be excused for trusting their instincts, their values, and their own common sense. We have a long legacy of many of our most respected leaders and profound thinkers rejecting the notion that consumer lending markets are naturally efficient. For example, while the Founding Fathers were passionately committed to the value of freedom, they had virtually no confidence in the inherent efficiency of financial markets. President George Washington, the Father of Our Country, explained:

> [T]here is no practice more dangerous than borrowing money . . . for when money can be had in this way, repayment is seldom thought of in time . . . [.] Exertions to raise it by dint of industry ceases. It comes easy and is spent freely and many things indulged in that would never be thought of, if to be purchased by the sweat of the brow. In the mean time, the debt is accumulating like a snowball in rolling.[154]

Thomas Jefferson, the principal author of the Declaration of Independence,[155] famously feared banks more than he feared standing armies.[156] And Benjamin Franklin, an advocate of the Bill of Rights, wrote:

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153. *See Regulatory Restructuring and Reform of the Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. app. 159 (2008) (prepared statement of Joseph E. Stiglitz, Professor, Columbia University) (providing testimony of Professor Stiglitz, a Nobel-Prize-winning economist, that "[e]xploitive practices of the financial sector need to be curbed"). Professor Stiglitz further explained:

> The financial sector realized that there was money at the bottom of the pyramid, and they moved with all speed to ensure that it moved to the top. The exploitive practices include pay-day loans, predatory lending, and rent-a-furniture and similar scams. There needs to be a usury law (and this also applies to credit cards) limiting the effective rate of interest paid by users of the financial facility.

Id.

154. RON CHERNOW, WASHINGTON: A LIFE 108 (2010).

155. *See, e.g.*, *Thomas Jefferson*, THE LIBRARY OF CONGRESS EXHIBITION (July 22, 2010), http://www.loc.gov/exhibits/jefferson/jeffdec.html (last visited Apr. 3, 2012) ("Jefferson retained his prominent role in writing [the Declaration of Independence.]") (on file with the Washington and Lee Law Review).

156. Letter from Thomas Jefferson to John Taylor (May 28, 1816), *in* 11 THE WORKS OF THOMAS JEFFERSON IN TWELVE VOLUMES, FEDERAL EDITION 533 (Paul Leicester Ford, ed., 1905), *available at* http://files.libertyfund.org/files/

> [T]hink what you do when you run in debt; you give to another power over your liberty. . . .
>
> . . . When you have got your bargain, you may, perhaps, think little of payment; but *creditors . . . have better memories than debtors* . . . . The day comes round before you are aware, and the demand is made before you are prepared to satisfy it, or if you bear your debt in mind, the term which at first seemed so long will, as it lessens, appear extremely short. Time will seem to have added wings to his heels as well as shoulders. . . . *The borrower is a slave to the lender, and the debtor to the creditor*, disdain the chain, preserve your freedom; and maintain your independency: be industrious and free; be frugal and free.[157]

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

Indeed, Adam Smith himself lacked confidence in the efficiency of consumer finance markets. Instead of relying on his own insights into naturally efficient markets, Smith emphasized the importance of the overconfidence bias in financial decision-making, stating that "[t]he over-weening conceit which the greater part of men have of their own abilities, is an ancient evil remarked by the philosophers and moralists of all ages. . . . The chance of gain is by every man more or less over-valued, and the chance of loss is by most men under-valued . . . ."[158] Indeed, in his great treatise, *The Wealth of Nations*, Adam Smith argued that behavioral patterns such as overconfidence bias and hyperbolic discounting made usury limits indispensible.[159] In his words, high interest rate limits allow money to be lent to "prodigals and projectors" that are "likely to waste and destroy" capital overall.[160] Instead, Smith argued that usury limits should be set "somewhat above . . . the lowest market rate."[161] With

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807/0054-11_Bk.pdf ("And I sincerely believe, with you, that banking establishments are more dangerous than standing armies . . . .").

157. Benjamin Franklin, *The Way to Wealth*, *in* 1 THE NORTON ANTHOLOGY OF AMERICAN LITERATURE 213, 217–18 (Nina Baym et al. eds., Shorter 4th ed. 1995) (1733).

158. ADAM SMITH, 1 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 124 (Edwin Cannan ed., Modern Library 1994) (1776).

159. *See id.* at 388 (arguing for a rate limit to protect borrowers).

160. *Id.*

161. *Id.*

respect to high-cost loans, the inventor of the invisible hand did not believe in the invisible hand.[162]

IV. Zoning in the Void: The Local Response to Predatory Small Loans

Like Adam Smith, many local government leaders believe states should enact usury laws to limit prices in the market for small consumer loans. To this effect, many local governments feel compelled to fill the void in leadership in protecting citizens against predatory lending in the absence of effective state and federal action.[163] Moreover, because public opinion favoring limits on small-loan pricing has proven more durable than the limits themselves, local leaders face significant constituent pressure to respond to payday and car-title lending.[164] In the past few years, at least 135 local governments have attempted to restrict, regulate, or otherwise arrest the development of usurious lending within their boundaries.[165] Local governments with starkly different political and demographic profiles have reached similar conclusions regarding the need to inhibit predatory small loans within their neighborhoods.[166] For example, San Francisco, one of the nation's most liberal cities, has adopted a fringe lending ordinance very similar in approach to those found in small, conservative towns like Little Elm, Texas and American Fork, Utah.[167] Even still, this

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162. *See id*. (arguing for a rate limit); *see also supra* note 158 and accompanying text (explaining Adam Smith's "invisible hand" theory).

163. *See* Griffith, Hilton & Drysdale, *supra* note 16, at 2, 14 (concluding that many states do not pass laws to protect consumers from usurious payday lending, so "[l]ocal governments are left to address the problem of payday lenders on their own").

164. *See id*. (discussing local leaders' reactions to public opinion against predatory loans).

165. *Id.* at 15–20.

166. *See id*. (listing many different cities with similar limits).

167. *Id.* at 16, 18 (listing payday-lender ordinances of several localities, including American Fork, Utah); Pallavi Gogoi, *Costly Cash: In Texas, Towns Try Zoning Out Payday Lenders*, DAILY FIN. (Mar. 10, 2010), http://www.dailyfinance.com/2010/03/10/costly-cash-in-texas-towns-try-zoning-out-payday-lenders (last visited Apr. 3, 2012) (identifying Texas municipalities, including Little Elm, that have "wage[d] war against money stores") (on file with the

significant ground-swell of local support for restrictions on predatory small loans likely understates the actual support for regulation because the limits on local government power probably deter some governments from acting.[168]

Local leaders hoping to inhibit predatory lending within their communities must contend with federal and state preemption of their ordinances. Federal preemption controls local ordinances just as it does state legislatures.[169] So, for instance, local governments lack the power to cap interest rates charged by banks and credit unions under the Supreme Court's *Marquette* doctrine and its related legislative buttressing.[170] Moreover, statutes adopted by state legislatures can, in some contexts, also preempt local ordinances.[171]

Nevertheless, local governments do retain some powers traditionally reserved for local governments.[172] Some local leaders have aggressively pushed the outer boundaries of these powers by attempting to eliminate predatory small loans within their cities or

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Washington and Lee Law Review); *7 on Your Side: New Rules for Payday Lenders*, (ABC7 KGO-TV San Francisco Television Broadcast Dec. 26, 2007), *available at* http://abclocal.go.com/kgo/story?section=news/7_on_your_side&id=5856908 (discussing the San Francisco ordinance that "no new payday lenders will be allowed to set up shop within a quarter of a mile of an existing one").

168. *See, e.g.*, Rudolph Bush, *Dallas Council Urged to Limit Payday Lending Sites*, DALL. MORNING NEWS (Jan. 3, 2011), http://www.dallasnews.com/news/community-news/dallas/headlines/20110103-dallas-council-urged-to-limit-payday-lending-sites.ece (last visited Apr. 3, 2012) ("Council member Tennell Atkins, who[se] . . . district is home to dozens of payday-lending stores, said he's '125 percent against them.' But a resolution to the Legislature may be an empty gesture. . . . The industry's powerful lobbying arm has spread hundreds of thousands of dollars to elected officials in Austin.") (on file with the Washington and Lee Law Review).

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

170. *See supra* notes 27–37 and accompanying text (summarizing *Marquette* and its aftermath).

171. *See infra* Part V.B. (discussing the law of state preemption of local ordinances).

172. *See, e.g.*, *infra* note 250 and accompanying text (stating that courts typically allow local governments to regulate consumer finance).

counties. For example, Jacksonville, Florida adopted an ordinance attempting to cap payday loan prices.[173] Florida state law generally imposes a usury limit of 18%.[174] Lenders exceeding this price cap without a license are subject to criminal prosecution.[175] But, the Florida legislature has also granted licenses to payday lenders allowing them to charge fees amounting to an interest rate of approximately 300% on a typical payday loan.[176] Many Florida payday lenders ignore this high limit by purporting to partner with a broker, called a credit service organization, that charges a fee for arranging the payday loan.[177] In effect, many payday lenders entirely ignore Florida's triple-digit interest rate price cap through this loophole.

Resentful of the consequences of these loans for its citizens, particularly the many military service members stationed at a local navy base, Jacksonville attempted to push for a more consumer-friendly usury law by adopting its own 36% interest rate limit.[178] The city took the position that the state's price cap on payday lending constituted a consumer protection floor that the city could raise if it chose to do so.[179] Nothing in the state's payday lending statute explicitly contradicted this interpretation.[180] Nevertheless,

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173. *See* Griffith, Hilton & Drysdale, *supra* note 16, at 30–36 (providing the Jacksonville ordinance regulating payday-lending practices).

174. FLA. STAT. §§ 687.02(1), 687.03(1) (2011).

175. *Id*. Unlicensed lending—even in large amounts—at annual interest rates above 25% is a crime in the state of Florida. *Id.* § 687.071.

176. *See id.* § 560.404(6) (allowing payday lenders to charge up to 10% of the loan plus a verification fee); Peterson, *supra* note 7, at 1123–24 (explaining how a fee of $52 can amount to a triple-digit interest rate on the payday loan).

177. *See* Peterson, *supra* note 7, at 1152–53 (explaining how payday lenders partner with credit service organizations "to make payday loans outside the scope of state price limits" (citations omitted)).

178. *See* Griffith, Hilton & Drysdale, *supra* note 16, at 26, 30–36 (providing the 2005 Jacksonville ordinance, which "reduc[ed] the interest rate to 36%" because "payday lending practices in general have proven to be detrimental to numerous individuals[,] including military service members").

179. *See id.* at 31–32 ("This [statute] is supplemental to all other laws or ordinances, and in no way impairs or restricts the authority granted to the Florida Department of Financial Services, or any other regulatory authority with concurrent jurisdiction over the matters stated in this chapter.").

180. *See* Advance Am., Cash Advance Ctrs. of Fla., Inc. v. Consol. City of Jacksonville, Fla., No. 16-2005-CA-7025-MA, slip op. at 2–3 (Fla. Cir. Ct. June 1, 2006) (stating that the state payday lending statute does not explicitly define

when a payday lender challenged the city's ordinance, a state trial judge struck down the price cap, finding that the state legislature had intended to preempt local price regulation.[181]

Less direct than Jacksonville's ordinance, a St. Ann, Missouri ordinance attempted to prevent triple-digit payday lending within its city by framing its prohibition as an exercise of municipalities' traditional right to use zoning law for land-use planning.[182] The Missouri legislature adopted a statute that authorizes licensed payday lenders to collect interest and fees up to 75% of the initial principle of any single loan.[183] While there is some ambiguity in the statute, the law's most simple interpretation appears to authorize accrued interest of 75% of the loan principle, which, for a typical two-week payday loan of $325, constitutes an astounding annual interest rate of 1955.36%.[184] Concerned about the stability and propriety of this type of lending, St. Ann acted to protect its citizens with an ordinance that read:

> A business engaged in providing short-term loans to members of the public as a primary or substantial element of its operations and which is not licensed by the appropriate state or federal agency as a bank or savings and loan association[] . . . is prohibited in all zoning districts of the City of St. Ann.[185]

While the ordinance did not presume to cap interest rates—something that would have clearly contradicted Missouri's

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the elements of the payday-lending relationship).

181. *See id.* at 2.

182. *See* State *ex rel.* Sunshine Enters. of Mo. v. Bd. of Adjustment of St. Ann, 64 S.W.3d 310, 311–13 (Mo. 2002) (stating that St. Ann viewed its ordinance prohibiting payday lenders as "a land use 'zoning' regulation," which would be "presumptively within the police power" (citations omitted)); *see also* Griffith, Hilton & Drysdale, *supra* note 16, at 27 (describing the St. Ann ordinance).

183. MO. REV. STAT. §§ 408.100, 408.505.3 (2011).

184. *See* Peterson, *supra* note 7, at 1139 ("A $325 loan that grows 75% in 14 days carries an annual percentage rate of 1955.36%."); *APR Calculation Formula*, MO. DIVISION OF FIN., http://finance.mo.gov/consumercredit/apr.php (last visited Apr. 3, 2012) (showing how a 75% interest rate can yield an enormous annual interest rate) (on file with the Washington and Lee Law Review).

185. *Sunshine Enters.*, 64 S.W.3d at 312 (providing the St. Ann, Missouri ordinance that the court overrules) (citation omitted).

extremely high price limit on payday loans—it did refuse to grant a local business license to any non-depository short-term lender.[186] A payday lender brought suit challenging the ordinance, and the case eventually made its way to the Missouri Supreme Court.[187] The court held that, although the ordinance purported to be a zoning measure, state law nonetheless preempted it because St. Ann had prohibited an activity that state law permits.[188]

So limited, some local governments have attempted to use the persuasive power of their moral authority, rather than the operation of law, to prevent predatory small loans. For example, some cities and counties have adopted non-binding resolutions demanding that their state legislatures re-establish traditional usury limits.[189] Local governments in Virginia, where legislative battles on payday and car-title lending have become a seasonal fixture, have pursued this strategy in particular.[190] Over thirty different local governments have adopted non-binding resolutions demanding that Virginia re-establish a traditional usury limit of 36%.[191] But, as this Article goes to press, a majority of the Virginia Assembly remains unpersuaded.

While Jacksonville and St. Ann serve as examples of ordinances that did not survive judicial challenges, there are many more local governments that have taken measures that remain in force. In recent years, local governments have turned to their well-accepted power to adopt zoning ordinances to stem the tide of payday and car-title lending within their jurisdictions. These zoning ordinances

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186. *Id.*

187. *Id.* at 310.

188. *See id.* at 314 ("Where the city prohibits a business that state law permits, the city has the burden to show that the ordinance does not conflict with state law. . . . In this case, the city has not shown that Ordinance 2074 is a valid exercise of the zoning power.").

189. *See, e.g.*, Resolution No. 3202, § 1, Sachse, Texas (April 5, 2010) (urging the state legislature and Governor of Texas to enact laws to "[c]lose the *loophole* in state law that allows payday, auto title, and other consumer loans to carry annual percentage rates upwards of 500%.").

190. *See* Anita Kumar, *Pressure Mounts on Va. Payday Lenders: Coalition Plans to Push Legislature for Limits*, WASH. POST, Dec. 3, 2007, at B01 ("More than [thirty] Virginia cities and counties have approved resolutions seeking stricter regulations.").

191. *See* Griffith, Hilton & Drysdale, *supra* note 16, at 20 ("During 2007 and 2008 at least 37 cities in Virginia passed a resolution asking the state assembly to cap payday loan interest rates.").

tend to take one or more of three basic forms: (1) restrictions on the location where predatory lenders can operate; (2) discretional permits that restrict who may obtain licenses to engage in predatory lending; and (3) permanent or temporary limits on the number of predatory lending locations within a jurisdiction.

First, perhaps the most common local restriction on predatory lending outlets is a limit on where lenders can locate. Some jurisdictions restrict the proximity of predatory lenders to residences, churches, schools, or other protected buildings. For example, Oakland, California prohibits the location of check cashiers within 500 feet of any school.[192] Some local governments also restrict predatory lenders from clustering together by requiring a minimum distance separating locations.[193] There is considerable variety in the required minimum distance, with some leaders adopting a cosmetic 600 feet and others requiring as much as a mile of separation.[194] Other local leaders have protected specially zoned commercial districts or streets where predatory lenders are not allowed. For example, Sachse, Texas prohibits payday lenders, check cashers, and car-title lenders from locating within 500 feet of the President George Bush Tollway.[195]

Second, many local governments have adopted ordinances that require a special permit prior to opening a predatory lending location.[196] These conditional permits typically require an application and a public hearing in front of some type of land-use planning board.[197] These hearings give local governments an

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192. OAKLAND, CAL., PLANNING CODE § 17.102.430(A)(2) (2004) (restricting check-cashing activities from operating near certain protected facilities).

193. *See, e.g.*, CASA GRANDE, ARIZ., CODE OF ORDINANCES § 17.12.415(A) (2009) (requiring a minimum distance of 1,320 feet separating deferred presentment companies).

194. *Compare* WEST VALLEY CITY, UTAH, CODE § 7-1-103(30) (2011) ("No check cashing or deferred deposit loan business shall be located within 600 feet of any other check cashing business."), *with* SANDY CITY, UTAH, LAND DEVELOPMENT CODE, § 15A-11-20(A)(1) (2008) (stating that non-depositary financial institutions "[s]hall not be located within 5,280 feet (one mile) of the same type of use inside or outside the Sandy City geographical boundaries").

195. SACHSE, TEX., CODE OF ORDINANCES ch. 11, art. 3, § 11.2(c)(1) (2009).

196. *See, e.g.*, ST. LOUIS COUNTY, MO., CODE OF ORDINANCES tit. X, § 1003.133(3)(21) (2009) (requiring small-loan businesses to obtain a permit before locating in certain areas).

197. *See, e.g.*, *id.* § 1003.181(8) (describing procedures for obtaining the

opportunity to look into the background of the permit applicant and consider the merits of the proposed location. While there is variation in local practices, the ordinances that create these conditional permit requirements tend not to impose overly restrictive standards on who can receive a permit. In practice, these permit requirements create a small barrier to entry but typically do not empower planning boards to effectively eliminate predatory small-loan outlets in their communities.[198]

Third, some jurisdictions have explicitly limited the number of predatory small-loan locations that may exist within their communities. For example, the leaders of St. Ann, Missouri, who unsuccessfully attempted to prohibit all payday lenders in their town, have since limited payday lenders to no more than three locations.[199] Some cities and counties have adopted limits relative to the population. For example, West Valley City, Utah has an ordinance limiting payday lenders to no more than one store per ten thousand residents.[200] Still, other governments have adopted temporary moratoriums prohibiting new locations while the government leaders study and debate how to respond to predatory lending.[201]

Unfortunately, each of these zoning strategies suffers from systemic weakness. Almost without exception, zoning restrictions

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conditional-use permit, including an application and a hearing).

198. If the permits are overly restrictive in a state that permits such establishments, courts would likely strike down the ordinance as prohibitive and contrary to state law. *See* State *ex rel.* Sunshine Enters. of Mo. v. Bd. of Adjustment of St. Ann, 64 S.W.3d 310, 314 (Mo. 2002) (holding invalid a city ordinance that effectively prohibited businesses otherwise permitted under Missouri law).

199. *See* ST. ANN, MO., MUNICIPAL CODE tit. IV, ch. 400, § 390(23) (2011) (limiting the number of short-term loan establishments in the C-2 district to three). The C-2 district is the only district in St. Ann that allows short-term loan establishments; all other districts that allow businesses specifically exclude these establishments or include only other, enumerated businesses. *Id.* §§ 20, 290(H), 460(12), 550–70.

200. *See* WEST VALLEY CITY, UTAH, CODE § 7-1-103(30) (2011) (allowing one deferred-deposit loan business per ten thousand citizens living in West Valley City).

201. *See, e.g.,* Ruth Ingram, *Business Ban Still in Effect in Clinton,* CLARION-LEDGER, Mar. 15, 2010, at A9 (discussing Clinton, Mississippi's moratorium on new payday loan stores).

have provided too little protection too late. Local governments established limits on the number of locations after the predatory lenders already saturated the city, town, or county with outlets.[202] Indeed, this saturation has typically served as the political impetus for the ordinance in the first place.[203] Most local governments have felt compelled to grandfather-in existing locations, which effectively cements the unsatisfactory development pattern in place for the long term.[204] Moreover, minimum-distance restrictions on predatory lender locations may look good on paper but actually provide minimal inhibition of the lenders' business models. Payday lenders themselves report in their SEC disclosures that they generally attempt to locate within three miles of their target demographic.[205] Virtually all the distance limits adopted throughout the United States are too small to impede the basic business model of predatory small-loan businesses. Zoning barriers to entry may, in effect, actually serve only to inhibit whatever minimal competition exists within the predatory lending market. Although excluding payday or car-title lenders from some favored districts may be cosmetically appealing, it does little to protect vulnerable citizens from financial predators. Ironically, many of the zoning restrictions only serve to "force" predatory lenders to locate in the poor, often minority

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202. *See, e.g.*, *id.* (providing an example of how fifteen "shops classified as either pawn, loan or title loan, payday loan, check-cashing, or check or cash advance" remained unaffected by the city's moratorium).

203. *See, e.g.*, Tim Jones, *States to Payday Lenders: Denied: Governments Curb Loan Operators That Have Grown So Much They Outnumber McDonald's Outlets*, CHICAGO TRIB., Mar. 23, 2008, at 3 (discussing how the "explosive" growth of payday lenders has led some state legislatures to debate rate caps and other reforms).

204. *See, e.g.*, NORWALK, CAL., MUNICIPAL CODE ch. 17.04, art. II, § 95(D) (2012) ("Any payday loan establishment lawfully existing prior to the effective date of the ordinance codified in this section and which is licensed by the City of Norwalk[] shall be allowed to remain on the same property . . . .").

205. *See, e.g.*, Check Into Cash, Inc., *Form S-1 Registration Statement Under the Securities Act of 1933*, SEC ARCHIVES, 33 (July 31, 1998), http://www.sec.gov/Archives/edgar/data/1067289/0000931763-98-001978.txt (last visited Apr. 3, 2012) [hereinafter Check Into Cash] (stating that Check Into Cash "seeks to open each new store within three miles of the market area that it is intended to serve") (on file with the Washington and Lee Law Review).

neighborhoods and strip malls that they wanted to operate in anyway.[206]

But perhaps the most unsatisfactory result of local ordinances is their propensity to demobilize efforts for more meaningful change. Zoning ordinances have been relatively easy to pass precisely because predatory lenders do not view these rules as a threat to their activities.[207] In reality, while zoning ordinances do very little to protect vulnerable families from abusive financial products, they do provide political cover for leaders who do not want to risk offending the powerful predatory finance lobby.[208] Well-intentioned local governments can declare a "victory," congratulate themselves with an article in the local newspaper, and leave the basic underlying problem unsolved. There is little indication that these zoning ordinances have been part of effective campaigns building toward more lasting and meaningful legal changes.[209]

V. Plainspoken Leadership: A Proposal for Cautionary Signage Ordinances

This Part proposes a local ordinance strategy through which local leaders could both provide meaningful consumer protection and send a strong message mobilizing their community toward traditional limits on predatory loans. Appendix A, which follows this Article, includes a "Model Small Predatory Lending Ordinance." This ordinance proposes that local governments require a

206. *See* James H. Carr & Lopa Kolluri, *Predatory Lending: An Overview*, *in* FINANCIAL SERVICES IN DISTRESSED COMMUNITIES: ISSUES AND ANSWERS 30, 31, 35 (Fannie Mae Found. 2001) (presenting data that the subprime lending market concentrates in low-income, minority neighborhoods and that lenders target limited-income households).

207. *See, e.g.*, Peterson, *supra* note 7, at 1157 ("The counterintuitive irony is that high cost lenders actually advocated for the very exceptions and loopholes that have raised the compliance costs associated with nonuniform state policymaking." (citation omitted)).

208. *See, e.g.*, *id.* at 1111 & n.2 (stating that the payday-lending industry spends millions on lobbying and public relations).

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

cautionary message on signs at businesses offering credit at annual percentage rates exceeding 45%.[210] The signage requirements of the proposed small predatory lending ordinance are divided into two different types.

First, the ordinance requires that all of the exterior signs at a predatory lending business carry a local government cautionary message.[211] For example, an ordinance adopted by the city of "Anywhere" would read: "City of Anywhere Warning: Predatory Lender." The ordinance requires that the display of this cautionary message covers one-third of the spatial area on each exterior sign[212] and that the text of the cautionary message be black on a white background.[213] While the proposed ordinance requires that predatory lenders display the warning on any of their exterior signs, the warning is not required if the lender forgoes exterior signage.[214] Thus, the warning requirement is "tailored to match the degree to which a predatory lender advertises at its location. The amount of required warning signage matches the amount of predatory lending advertisement chosen by the predatory lender."[215]

Second, the ordinance requires the display of official door signs created and distributed by the director of a city or county department who is charged with enforcing the ordinance.[216] The ordinance requires display of these door signs on all exterior doors of a predatory lending facility.[217] These official door signs include the cautionary message in the same color and font pattern as the warnings displayed on the lender's existing exterior signs.[218] But, the cautionary door sign also includes an additional explanation indicating: that the city or county in question has determined that the facility displaying the sign engages in predatory lending; that the local government requires predatory lending warnings on

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210. *Infra* Appendix A § 600.
211. *Infra* Appendix A § 600(b).
212. *Id.*
213. *Id.*
214. *Id.* § 600 official cmt. 2.
215. *Id.*
216. *Infra* Appendix A § 600(c), (d).
217. *Infra* Appendix A § 600(c).
218. *See infra* Appendix A § 600(e) ("[P]redatory lending door signs shall have black, Arial, all-capitals text with a white background.").

displayed signs under a consumer protection law; that the lender offers loans at interest rates above 45%; and, that "[t]hese loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship."[219]

In addition to signage requirements, the proposed ordinance includes a few other features designed to defend and enforce the ordinance. With respect to the former, predatory lenders are likely to challenge this ordinance in court. To this end, the proposed ordinance includes legislative findings based upon empirical research regarding the consequences of predatory lending.[220] The model ordinance also includes official comments that explain the various provisions of the statute, including graphic illustrations of the ordinances' signage requirements.[221] With respect to enforcement, the model ordinance requires all businesses lending at annual percentage rates (APR) in excess of 45% to obtain a permit.[222] The permit requirement includes a licensing fee to cover the cost of enforcement of the ordinance and to generate revenue for the city or county.[223] The proposed ordinance allows either the local government agency charged with enforcing the act or former borrowers to bring lawsuits to enforce the ordinance.[224] Similar to federal consumer-protection laws, the ordinance instructs courts to award modest statutory damages, court costs, and reasonable attorney fees to the local government or private plaintiffs that succeed in an enforcement lawsuit.[225]

There is no question that predatory lenders will be incensed by the proposed predatory small loan ordinance suggested in this Article. But their visceral reaction is born from the painful reality of their commercial behavior. The truth of what these businesses have become is hurtful. Despite their public relations and government

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219. *Id.*

220. *See infra* Appendix A § 200 (providing findings about the predatory practices of high-cost loans).

221. *See, e.g.*, *infra* Appendix A § 600 official cmt. 3 (providing illustrations of signs).

222. *Infra* Appendix A §§ 500(a), 300(e).

223. *See infra* Appendix A § 500(b) (imposing an annual fee of approximately $10,000).

224. *Infra* Appendix A § 700(b), (c).

225. *Id.*

lobbying efforts to the contrary, lenders that charge exorbitant interest rates to American families are false friends of the working poor and middle classes. While these lucrative companies have, in many instances, invested their profits in forging their polished corporate brands, local government leaders are under no obligation to play along with efforts to camouflage abusive loans. Indeed, as President Reagan once explained, "To grasp and hold a vision, to fix it in your senses—that is the very essence, I believe, of successful leadership . . . ."[226] The proposed ordinance in Appendix A is useful because it provides a reoccurring, simple, and boldly featured message of warning to potential victims of abusive commercial behavior. Instead of confusing, numeric information that many Americans cannot understand,[227] the proposed ordinance clearly signals the danger associated with predatory loans. High-cost lenders will object to this warning not because it is inaccurate but because they realize its power and effectiveness.

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

The proposed model ordinance includes a clear and enforceable bright-line price threshold of 45% APR for identifying predatory small loans. This is an appropriate threshold for at least two reasons. First, the characterization of loans at prices above 45% APR as "predatory" reflects the policy objectives of federal law. Under current federal criminal law, an annual actuarial interest rate in excess of 45% is considered one factor in establishing prima facie evidence that a loan is extortionate.[228] Extortionate lending is a serious crime, punishable by up to twenty years in

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226. Ronald Reagan, President, Remarks at a Luncheon Hosted by Artists and Cultural Leaders in Moscow (May 31, 1988), *available at* http://www.reagan.utexas.edu/archives/speeches/1988/053188a.htm.

227. *See* Jeffrey Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841, 876–79, 920 (1977) (providing data that only a small percentage of study participants could understand how to calculate the full cost of credit).

228. 18 U.S.C. § 892(b)(2) (2006).

federal prison.[229] While there are, of course, additional elements factored into the criminal prosecution of extortionate lending, the prima facie evidentiary threshold of 45% reflects the congressional judgment that prices above this interest rate are indicative of criminal, and by implication predatory, behavior.[230] In common usage, the term "predatory" merely indicates that a behavior is inclined to injure or exploit for personal gain or profit.[231] For over forty years, federal law has held that loan prices in excess of 45% are indicative of illicit and exploitative intentions.[232] Because Congress has used this threshold as a legal device suitable, in part, for determining when high-cost lenders should be incarcerated, it is also appropriate as a threshold in warning potential victims of the likelihood of this potentially criminal and predatory behavior.

Second, while the 45% evidentiary threshold in federal law does not, by itself, establish a criminal limit, many other federal and state laws, both today and in the past, use an interest rate limit as the conclusive standard of illegal and, in many states, criminal behavior. For example, federal law establishes a 36% APR usury limit on loans made to military service members and their

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229. *Id.* § 892(a).

230. The conference report on the Consumer Credit Protection Act justifies the 45% evidentiary threshold thus:

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

H.R. REP. NO. 90-1397, at 30 (1968) (Conf. Rep.).

231. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 977 (11th ed. 2011).

232. *See* Consumer Credit Protection Act of 1968, Pub. L. No. 90-321, § 202, 82 Stat. 146, 159–61 (codified as amended at 18 U.S.C. § 892(b)(2) (2006)) (stating that an annual actuarial interest rate above 45% is a factor in establishing prima facie evidence of extortionate credit); *see also* Edward L. Rubin, *Legislative Methodology: Some Lessons From the Truth-in-Lending Act*, 80 GEO. L.J. 233, 261 (1991) (discussing the House's 1968 passage of an amendment to the Truth and Lending Act that labeled "loan sharking" a federal offense); Christopher L. Peterson, *Truth, Understanding, and High Cost Consumer Credit: The Historical Context of the Truth in Lending Act*, 55 FLA. L. REV. 808, 879–80 (2003) (discussing the addition of extortionate credit provisions to the Truth and Lending Act).

dependents.[233] In the recent past, all fifty states had usury limits on small consumer loans, typically at a price threshold much lower than the 45% threshold in this Article's proposed ordinance.[234] Currently, New York City, the nucleus of American finance, continues to do business without pause under the shadow of a strictly enforced criminal interest rate limit of 25%.[235] Georgia punishes violations of its usury limit with up to a year in prison.[236] Similarly, in Florida, the label "loan shark" is a legal term of art defined by statute.[237] Unlicensed lenders in Florida are guilty of misdemeanor "loan sharking" when they willfully lend at annual interest rates in excess of 25%.[238] Unlicensed lending at interest rates of above 45% is punishable as a third-degree felony.[239] If in all these jurisdictions, the government can sue and even imprison lenders for victimizing borrowers with abusive pricing, surely it is also appropriate, indeed commendable, to *at least* provide an

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233. John Warner National Defense Authorization Act for Fiscal Year 2007, 10 U.S.C. § 987(b) (2006).

234. *See* Peterson, *supra* note 7, at 1160–61 (outlining the "usury-limited credit market" of the 1950s and 1960s).

235. N.Y. PENAL LAW § 190.40 (McKinney 2011).

236. GA. CODE ANN. § 16-17-2(d) (2011).

237. FLA. STAT. ANN. § 687.071(1)(f) (West 2011) ("'Loan shark' means any person as defined herein who lends money unlawfully under subsection (2), [or] subsection (3) . . . .").

238. *Id.* § 687.071(2). This subsection provides:

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

Id.

239. *Id.* § 687.071(3). This subsection provides:

> Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take, or receive interest thereon at a rate exceeding 45 percent per annum or the equivalent rate for a longer or shorter period of time, whether directly or indirectly, or conspires so to do, commits a felony of the third degree . . . .

Id.

effective and prominent warning to borrowers who do not enjoy the benefit of comparable protections.

Given the tradition and current laws of many states that outlaw loans at interest rates higher than 45%, some local government leaders will view this threshold as set too high. Arguably, it would be more appropriate to set the threshold limit at 36% to mirror the most common American small-loan limit throughout the twentieth century,[240] as well as the federal cap on loans to military service members.[241] Moreover, there are many financial practices that are fairly characterized as predatory independent of a 45% interest rate threshold.[242] For example, other abusive payday loan features and practices include: making loans without considering borrowers' ability to repay; imposing balloon payments that force repeated refinancing; using checks or automated clearing house debit authorizations to coerce repayment; imposing pyramiding or otherwise excessive late fees; and charging excessive attorneys' fees in the collection of small debts—all of which are independent of the loan's basically excessive price. Similarly, in the mortgage lending market, many subprime and exotic mortgage loans were predatory, not because of their interest rate, but because they targeted the value of the family's home or relied on flawed underwriting.[243] Nevertheless, while not every predatory loan has an interest rate of 45%, many local government leaders may reasonably conclude that every loan with an interest rate of 45% is predatory.

Questions are likely to be raised regarding whether a variety of consumer loans fall within the scope of the proposed model ordinance. For example, tax-refund-anticipation loans, unsecured finance company loans, and pawnshop loans can sometimes carry

240. *See* Peterson, *supra* note 7, at 1142–43, 1161 (discussing a median usury limit of 36% APR in 1965).

241. John Warner National Defense Authorization Act for Fiscal Year 2007, 10 U.S.C. § 987(b) (2006).

242. *See, e.g.*, ELIZABETH RENUART, NAT. CONSUMER LAW CTR., STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES 28–32 (2002) (listing types of lenders).

243. *See, e.g.*, Patricia Sturdevant & William J. Brennan, Jr., *A Catalogue of Predatory Lending Practices*, 5 CONSUMER ADVOC. 4 (1999) (listing practices); Carr & Kolluri, *supra* note 206, at 32–35 (discussing fraudulent lending behavior).

interest rates in excess of 45%. Importantly, lenders can offer all of these forms of credit at more modest prices when combined with responsible underwriting and reputable collection methods. But, insofar as the federal Truth in Lending Act characterizes these forms of credit as carrying an APR exceeding 45%, the model ordinance as written will require the same signage warnings that will almost certainly be imposed on typical payday and car-title lending companies. Some lenders and merchants are likely to demand special exceptions under a proposed ordinance. However, making an exception for one type of merchant, practice, loan term, or another will open the door to claims of an unlevel playing field. It will ultimately erode the clear, bright line that is one of the primary advantages of the ordinance. By hinging the ordinance on federal law, local governments would harness a pre-existing body of law that has already had many years of thoughtful interpretation by regulators and courts. In contrast, as language attempting to grant exceptions is introduced into the model ordinance, the likelihood of predatory lenders developing strategies to exploit loopholes will increase. A 45% APR trigger will provide a high, yet clear, bright line with low compliance costs for businesses and simple enforcement for both courts and local governments.

B. A Predatory Lender Warning Signage Ordinance Is Not Preempted by State Law

There is considerable variation in the powers granted to local governments to regulate commercial activity. Unlike sovereign state governments, courts regard local governments as administrative subdivisions of their states that do not have "inherent" powers.[244] Some local governments have "home-rule" authority, generally thought to include all powers not expressly denied by state statute.[245] Other jurisdictions, in contrast, follow "Dillon's rule,"

244. 2 JOHN MARTINEZ, LOCAL GOVERNMENT LAW § 13:1 (2008).

245. *See, e.g.*, City of Detroit v. Walker, 520 N.W.2d 135, 138–39 (Mich. 1994) ("[I]t is clear that home rule cities enjoy not only those powers specifically granted, but they may also exercise all powers not expressly denied."). Nevertheless, "courts differ as to the nature of home-rule powers." MARTINEZ, *supra* note 244, § 13:3 (citations omitted). For further description of the law of home rule, see generally DALE KRANE, PLATON N. RIGOS & MELVIN B. HILL JR.,

which holds that local governments have only those powers "granted in express words" together with those powers necessarily implied or essentially granted by statute.[246] Even under this more restrictive approach, most states have expressly granted local governments the broad authority to enact any laws or regulations that are "reasonably related" to the promotion of "health, safety, morals, peace, or general welfare."[247] Nevertheless, local governments "may not enact . . . ordinances which are inconsistent with state law or which infringe the spirit of state law."[248] Generally speaking, "[a] state statute preempts municipal ordinances when either the language in the ordinance contradicts the language in the statute or when [the judiciary finds that] the [l]egislature has intended to thoroughly occupy the field [of regulation]."[249]

Courts have consistently held that, in the absence of express or field preemption, local authority to regulate for the general welfare includes authority to regulate consumer finance.[250] Most directly, in the past, some courts recognized the authority of local governments to directly cap interest rates on consumer loans.[251] Looking beyond the issue of price, courts have upheld local government authority to issue a wide variety of consumer-financial-services regulations. For example, courts have generally upheld permit requirements for

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HOME RULE IN AMERICA: A FIFTY-STATE HANDBOOK (2001).

246. Merriam v. Moody's Ex'rs, 25 Iowa 163, 170 (1868) (Dillon, C.J.), *superseded by constitutional amendment*, IOWA CONST. art. III, § 38A (1968), *as recognized in* City of Asbury v. Iowa City Dev. Bd., 723 N.W.2d 188 (Iowa 2006); JOHN F. DILLON, TREATISE ON THE LAW OF MUNICIPAL CORPORATIONS § 55 (Chicago, James Cockcroft & Co. 1872). The rule is named after John F. Dillon, an Iowa Supreme Court Justice and Columbia Law Professor. For a more detailed discussion of jurisprudence in Dillon's rule jurisdictions, see MARTINEZ, *supra* note 244, §§ 13:4–13:9. For a critical analysis of Dillon's rule and home rule, see Richard Briffault, *Our Localism: Part I—The Structure of Local Government Law*, 90 COLUM. L. REV. 1, 7–11 (1990).

247. 56 AM. JUR. 2D *Municipal Corporations* § 369 (2011) (citations omitted).

248. MARTINEZ, *supra* note 244, § 13:6; 56 AM. JUR. 2D *Municipal Corporations* § 315 (2010).

249. 56 AM. JUR. 2D *Municipal Corporations* § 316 (2010) (citations omitted).

250. *See* 7 EUGENE MCQUILLIN, MUNICIPAL CORPORATIONS § 24:334 (3d ed. 2005) ("[A] municipality can regulate usury under a general welfare clause."(citation omitted)).

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

pawnshops or other types of small consumer finance lenders.[252] Permit requirements are usually upheld even when the permit is duplicative of a state license.[253] And in some states, the enforceability of contracts may be challenged where the lender failed to obtain a local permit.[254] By way of example, the Ohio Supreme Court upheld the right of a local government to require that small lenders record details on every loan made and file weekly reports to a city auditor.[255] The Missouri Supreme Court held that local governments had the power to require that pawnbrokers take and maintain a photograph of every customer pawning merchandise.[256] Moreover, courts have generally upheld local ordinances that impose per-transaction fees on consumer lenders.[257] Local law regarding consumer financial services can be enforced through criminal sanctions, even when those sanctions are complementary or duplicative of state statutes.[258]

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252. *See, e.g.*, Iscoff v. Police Comm'n of San Francisco, 222 Cal. App. 2d 395, 401–05 (Dist. Ct. App. 1963) (pawnshop permit); Medias v. City of Indianapolis, 23 N.E.2d 590, 594 (Ind. 1939) (pawnbroker license); City of Rochester v. Bemel, 233 N.W. 862, 863 (Minn. 1930) (junk-dealer license); Provident Loan Soc'y v. City & County of Denver, 172 P. 10, 12 (Colo. 1918) (pawnbroker license); City of Seattle v. Barto 71 P. 735, 736 (Wash. 1903) (pawnbroker license); *see also* 7 MCQUILLIN, *supra* note 250, § 26:154.3 (collecting and analyzing cases upholding license requirements for pawnbrokers).

253. *See, e.g.*, Malish v. City of San Diego, 84 Cal. App. 4th 725, 736 (Dist. Ct. App. 2000) ("[T]he Legislature has expressly authorized duplicative ordinances regulating pawnbrokers by allowing the enactment and enforcement of ordinances that are not inconsistent with state law."); City of New Orleans v. Heymann, 162 So. 582, 584 (La. 1935) (upholding the city's license tax on small-loan lenders).

254. *See generally* Annotation, *Failure of Moneylender or Creditor Engaged in Business of Making Loans to Procure License or Permit as Affecting Validity or Enforceability of Contract*, 29 A.L.R. 4th 884, 884–896 (1984) (discussing the enforceability of a lender's contracts when the lender fails to obtain a permit).

255. Sanning v. City of Cincinnati, 90 N.E. 125, 127, 129 (1909).

256. Liberman v. Cervantes, 511 S.W.2d 835, 837–38 (Mo. 1974); *see also* Pawnmart, Inc. v. Gwinnett Cnty., 608 S.E.2d 639 (Ga. 2005) (upholding a local ordinance requiring pawnbrokers to obtain fingerprints and digital photographs of customers).

257. *See, e.g.*, USA Cash # 1, Inc. v. City of Saginaw, 776 N.W.2d 346, 357 (Mich. Ct. App. 2009) (stating that locally imposed, per-transaction fees imposed on pawnbrokers "do not conflict with state law regulating the same area merely because the state law imposes no fees").

258. *See, e.g.*, City of Hobbs v. Biswell, 473 P.2d 917, 920 (N.M. Ct. App.

Moreover, courts have traditionally regarded ordinances regulating signs as particularly within the authority of local governments.[259] For well over a hundred years, local governments have been regulating merchants' outdoor advertising.[260] While authority to regulate signs is not unlimited, from early on, courts have deferred to local signage ordinances. For example, Chicago won multiple litigation battles with billboard advertisers in the early twentieth century.[261] Today, there is extensive jurisprudence granting local governments the power to regulate outdoor signs in virtually every state in the republic.[262] Sign ordinances of many different types and purposes are routinely upheld, including limits on their location, construction, maintenance, size, and use.[263] A leading treatise explains that signage ordinances "are to be sustained upon the basis of promotion of the public safety, convenience, comfort, morals, and welfare of the inhabitants; more specifically, they constitute a legitimate exercise of the police power. . . ."[264] While the laws of each state are different, a New York court explained that municipalities traditionally have "wide latitude" to adopt ordinances concerning outdoor signs which "presumptively are valid."[265]

1970) ("With the enactment of [a state regulation], there is regulation of pawnbrokers by both the State and the municipality. The fact of double regulation does not result in the withdrawal of the municipality's authority to regulate. An ordinance may duplicate or complement statutory regulations.").

259. *See* Scadron v. City of Des Plaines, 606 N.E.2d 1154, 1159 (Ill. 1992) (finding that "municipalities have traditionally regulated outdoor advertising signs through the enforcement of local ordinances").

260. *See* Roger A. Cunningham, *Billboard Control Under the Highway Beautification Act of 1965*, 71 MICH. L. REV. 1295, 1346–47 (1973) ("[C]ases [from the early 1900s] may be found upholding the validity of municipal billboard regulation . . . .").

261. *See, e.g.*, Thomas Cusack Co. v. City of Chicago, 108 N.E. 340, 347 (Ill. 1914), *aff'd*, 242 U.S. 526 (1917) ("[F]ull power and authority are conferred upon cities, towns, and villages to regulate the construction and use of billboards within their corporate limits, provided the regulation is not unreasonable." (quoting City of Chicago v. Gunning Sys., 73 N.E. 1035, 1040 (1905))).

262. *See* 7 MCQUILLIN, *supra* note 250, § 24:379 (collecting cases granting authority to local governments to regulate outdoor advertising).

263. *Id.*

264. *Id.*

265. Village of Larchmont v. Sutton, 217 N.Y.S.2d 929, 934 (N.Y. Sup. Ct. 1961) (citations omitted). It is perhaps worth mentioning that Thomas

Given the strength of authority granting local governments the power to regulate both consumer finance and outdoor signage, it is unlikely that courts will find either express or field preemption of the model small-loan ordinance included in Appendix A. The very existence of over 130 zoning ordinances specifically targeting high-cost, small-loan lenders illustrates that state governments have not occupied the field of regulation over these lenders in every respect. Local governments continue to have broad zoning authority over consumer lenders because, like signage, this method of regulation is a matter of traditional local authority. Existing state regulations generally concern only the substantive terms and paperwork associated with loans.[266] A few states require the display of loan prices or the contact information of state regulators inside lenders' businesses.[267] Virtually no states have adopted consumer financial regulation on the *exterior signage* of lender locations. Moreover, a cautionary exterior signage ordinance would not contradict the express provisions of state consumer-protection statutes.[268] Legislatures that have adopted even the most anemic state payday and car-title lending laws generally have included laudatory language in their legislation on the importance of consumer protection.[269] A strongly worded local cautionary signage ordinance is consistent with the spirit of that public policy. Given the wide latitude traditionally given to local governments to regulate outdoor signs, courts should not hold that a local cautionary signage ordinance is preempted by the law of most states.

Matthews's influential treatise on model municipal ordinances includes an extensive list of regulations of all types of signs. *See generally* 4 THOMAS A. MATTHEWS, BYRON S. MATTHEWS & JUDITH O'GALLAGHER, MUNICIPAL ORDINANCES: TEXT AND FORMS ch. 51 (3d ed. 2010).

266. For an example of the substantive stipulations, see generally MO. REV. STAT. §§ 367.021–367.533 (2011).

267. *See, e.g.*, UTAH CODE ANN. § 7-23-401(1) (West 2011) (requiring lenders to post "a number the person can call to make a complaint to the [Utah Department of Financial Institutions] regarding the deferred deposit loan").

268. *See, e.g.*, MO. REV. STAT. §§ 367.185(5) (2011) ("[Lenders] shall post in a conspicuous location in each licensed office the maximum rates and fees that such person is currently charging on any loans made.").

269. *See, e.g.*, FLA. STAT. §§ 560.109(1), 560.408 (2011) (stating the intent to protect the public interest and prevent abuse of consumers).

C. A Predatory Lender Warning Signage Ordinance Is Constitutional

The First Amendment states that "Congress shall make no law . . . abridging the freedom of speech,"[270] and the Fourteenth Amendment imposes the First Amendment's freedom of speech restrictions on state and local governments.[271] The constitutional freedom of speech is a reflection of the American people's "profound national commitment to the principle that debate on public issues should be uninhibited, robust, and wide-open."[272] Nevertheless, not all forms of speech are treated the same under the Constitution. There are two potential lines of cases that courts might use to analyze the constitutionality of the proposed cautionary signage ordinance: first, the government speech doctrine, and second, the compelled commercial speech doctrine.[273] With respect to the former, "[t]he government-speech doctrine is relatively new, and correspondingly imprecise."[274] Courts are still gradually sorting out the criteria that will define when a communication constitutes the government's own speech communicated with the assistance of private parties and when it constitutes private speech that the government compels.[275] Moreover, there does not appear to be a consensus on the Supreme Court as to what distinguishes these forms of constitutional analysis.[276] Both types of government action

270. U.S. CONST. amend. I.

271. *See* Gitlow v. New York, 268 U.S. 652, 666 (1925) (stating that "freedom of speech and of the press—which are protected by the First Amendment from abridgment by Congress—are among the fundamental personal rights and 'liberties' protected by the [D]ue [P]rocess [C]lause of the Fourteenth Amendment from impairment by the [s]tates").

272. N.Y. Times Co. v. Sullivan, 376 U.S. 254, 270 (1964).

273. *See* Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio, 471 U.S. 626, 637–38, 651 (1985) (discussing government speech and compelled commercial speech).

274. Johanns v. Livestock Mktg. Ass'n, 544 U.S. 550, 574 (2005) (Souter, J., dissenting).

275. *See* Andy G. Olree, *Identifying Government Speech*, 42 CONN. L. REV. 365, 366 (2009) ("[T]he Court has yet to announce a standard by which judges can reliably identify government speech across a range of cases.").

276. For example, *compare Johanns*, 554 U.S. at 571 (Souter, J., dissenting) ("[A] compelled subsidy should not be justifiable by speech unless the government must put that speech forward as its own."), *with id.* at 564 n.7

are potentially constitutional, but the analysis and scrutiny applied by the Supreme Court differs. This subpart argues that the proposed cautionary signage ordinance is best viewed as constitutionally permissible government speech. But, even if courts determine that the warning signs are private speech, the ordinance is nonetheless a constitutional form of compelled commercial speech.

1. The Government Speech Doctrine

The proposed cautionary signage ordinance engages in constitutionally permissible government speech. In recent years, the United States Supreme Court has explained that "the Government's own speech . . . is exempt from First Amendment scrutiny."[277] The First Amendment precludes the government from impermissibly restricting freedom of speech, but it does not preclude the government from speaking. Thus, "[a] government entity has the right to 'speak for itself.'"[278] Indeed, government is "entitled to say what it wishes" and "to select the views that it wants to express."[279]

There are several examples of courts approving local government textual displays under the government speech doctrine. Most prominently, in *Pleasant Grove City v. Summum*,[280] the Supreme Court held that a monument reciting the Ten Commandments was a form of government speech not subject to First Amendment scrutiny.[281] A small religious group, called Summum, challenged Pleasant Grove City when the city refused to

(majority opinion) ("[T]he correct focus is not on whether the ads' audience realizes the Government is speaking . . . . [R]espondents enjoy no right not to fund government speech—whether by broad-based taxes or targeted assessments, and whether or not the reasonable viewer would identify the speech as the government's."); *see also* Pleasant Grove City v. Summum, 555 U.S. 460, 481 (2009) (Stevens, J., concurring) ("To date, our decisions relying on the recently minted government speech doctrine to uphold government action have been few, and in my view, of doubtful merit.").

277. *Pleasant Grove City*, 555 U.S. at 467 (quoting *Johanns*, 544 U.S. at 553).

278. *Id.* (quoting Bd. of Regents of Univ. of Wis. Sys. v. Southworth, 529 U.S. 217, 229 (2000)).

279. *Id.* at 467–68 (citations and internal quotation marks omitted).

280. *Id.* at 460.

281. *Id.* at 480.

allow the creed to donate its own religious monument for display alongside the city's Ten Commandments monument.[282] While the case also raised questions under the Establishment Clause, the Court granted certiorari specifically to analyze the right of governments to speak.[283] Justice Alito, writing for the majority, emphasized that "[g]overnments have long used monuments to speak to the public."[284] The Court explained that, although city parks create a public forum for some purposes, no First Amendment values were offended by the government's selective display of a religious monument.[285]

Although *Pleasant Grove City* dealt with a local government's permanent monument, lower courts have applied the same doctrine to more temporary local government textual displays. For example, in *Downs v. Los Angeles Unified School District*,[286] the Ninth Circuit reviewed a public school teacher's constitutional challenge to school officials' refusal to allow him to post materials on a bulletin board reflecting differing viewpoints on the school's gay and lesbian awareness month.[287] A Los Angeles public school maintained a school bulletin board on which faculty and staff could post materials.[288] Typical messages included content emphasizing acceptance of diversity and opposition to bullying.[289] The school principal refused to allow the teacher to maintain a separate bulletin board with material challenging the morality of homosexual and lesbian behavior.[290] The Ninth Circuit held that the school's sign was government speech and therefore immune from First

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282. *Id.* at 464–66.
283. *Id.* at 482 (Scalia, J., concurring).
284. *Id.* at 470 (majority opinion).
285. *Id.* at 480–81.
286. Downs v. L.A. Unified Sch. Dist., 228 F.3d 1003 (9th Cir. 2000).
287. *Id.* at 1005.
288. *Id.* at 1005–06.
289. *Id.* at 1006.
290. *Id.* at 1006–07.

Amendment scrutiny.[291] “Viewpoint neutrality” analysis did not apply “because it [was] a case of the government itself speaking.”[292]

Similarly, a third case dealt with the tobacco industry’s challenge to a state government’s imposition of a surtax on cigarette sales to fund an anti-tobacco advertising campaign that included billboard messages along with radio, television, and print advertising.[293] Among other messages, the advertising campaign included television advertisements displaying the text “WARNING: The tobacco industry is not your friend” and “WARNING: Some people will say anything to sell cigarettes.”[294] Rejecting the application of the compelled speech doctrine, the court instead applied the government speech doctrine in finding the speech constitutional.[295]

A more difficult question arises in determining what communications are government speech when there is some combination of private and public action. However, the government “is not precluded from relying on the government speech doctrine merely because it solicits assistance from nongovernmental sources.”[296] The Supreme Court has held that “[a] government entity may exercise this same freedom to express its views when it receives assistance from private sources for the purpose of delivering a government-controlled message.”[297] Similarly, the government may speak without First Amendment scrutiny where it “regulate[s] the content of what is or is not expressed . . . when it enlists private entities to convey its own message.”[298] For example, in *Pleasant Grove City*, the Supreme Court considered the Ten Commandments monument at issue to be government speech even

291. *Id.* at 1013 (“We conclude that when a public high school is the speaker, its control of its own speech is not subject to the constraints of constitutional safeguards and forum analysis . . . .”).

292. *Id.* at 1011.

293. R.J. Reynolds Tobacco Co. v. Shewry, 423 F.3d 906, 912 (9th Cir. 2005).

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

295. *Id.* at 920.

296. Johanns v. Livestock Mktg. Ass’n, 544 U.S. 550, 562 (2005).

297. Pleasant Grove City v. Summum, 555 U.S. 460, 468 (2009).

298. Rosenberger v. Rector & Visitors of Univ. of Va., 515 U.S. 819, 833 (1995).

though private citizens fabricated and donated the sign itself.[299] Similarly, in *Johanns v. Livestock Marketing Ass'n*, the Supreme Court reviewed a congressional program forcing farmers to subsidize a government advertising campaign promoting beef.[300] Despite the compelled private support for the program and the use of private entities in producing the advertising campaign, the Court nonetheless upheld the program as government speech.[301]

The key criteria announced by the Court in distinguishing government from private speech are whether the government "'effectively controlled' the messages sent" and whether the government is "exercising 'final approval authority' over [its] selection."[302] A federal district judge has emphasized that "[t]he determination as to whether speech is properly characterized as government speech or private speech turns entirely on 'who is responsible for the speech.'"[303] Several Supreme Court Justices have also emphasized that government speech is immune from First Amendment scrutiny only where it is clear that the government is speaking, as opposed to a private party.[304] The government is not allowed to avoid electoral accountability for its speech by concealing its message within the voice of private entities.[305]

In the proposed cautionary signage ordinance, a local government adopting the ordinance would "effectively control" the message conveyed in the municipal signs because the language of the signs is crafted within the city or county's legislative process.

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299. *Pleasant Grove City,* 555 U.S. at 464–65.

300. *Johanns*, 554 U.S. at 553–55.

301. *Id.*

302. *Pleasant Grove City*, 555 U.S. at 473 (quoting *Johanns*, 544 U.S. at 560–61).

303. R.J. Reynolds Tobacco Co. v. Bonta, 272 F. Supp. 2d. 1085, 1100 (E.D. Cal. 2003).

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

305. *Id.* at 577–79 (Souter, J., dissenting).

Indeed, there is even greater government control under the proposed ordinance than in either *Pleasant Grove City* or *Johanns*. In the former, the sign itself was created and donated by private citizens.[306] In the latter, the Court held that the beef advertising campaign was government speech even though the advertisements were produced and directed by private contractors, subject to approval by the government.[307] In the case of the proposed ordinance, the government not only effectively controls the message; indeed, it completely controls it by permitting no language other than the words the city or county government itself has spoken.

Moreover, there is no question that the cities and counties adopting the proposed ordinance would exercise final approval authority over the cautionary signs by voting in the legislative process to speak the very message adopted by the ordinance. Just as Pleasant Grove City had final approval authority on whether to display the donated Ten Commandments monument,[308] so too would local governments have final approval on the precise wording and format of predatory lender warning signs. In both the *Pleasant Grove City* display and the proposed ordinance, a local government is displaying language that it approves of and is accountable for.

While it is true that predatory lenders are likely to object to the message of the cautionary signage ordinance, there is no requirement of viewpoint neutrality in the government speech doctrine as applied to the proposed ordinance. High-cost lenders have no right to force the government to only say things that lenders agree with. As Justice Scalia has observed, "It is the very business of government to favor and disfavor points of view."[309] There is no credible argument that, by speaking to citizens in their own voices, local governments will close off a public forum of debate, since predatory lenders are free (and entirely likely) to respond vigorously with their own views. Similar to the school bulletin board in *Downs*, in the case of the proposed cautionary signage

306. Pleasant Grove City v. Summum, 555 U.S. 460, 464–65 (2009).

307. *Johanns*, 544 U.S. at 566–67.

308. *Please Grove City*, 555 U.S. at 473.

309. Nat'l Endowment for the Arts v. Finley, 524 U.S. 569, 598 (1998) (Scalia, J., concurring in judgment).

ordinance,"[w]e do not face an example of the government opening up a forum for either unlimited or limited public discussion."[310]

Furthermore, the proposed signage ordinance poses no risk that the source of the government speech will be misattributed to a non-governmental speaker. The signage ordinance's warning is "clearly identified as coming from the government itself."[311] To further emphasize the government as the source of the speech, the ordinance calls on the government to use its official municipal seal to visually reinforce that the language is the government speaking rather than the lender or some other private entity. There is no risk that the public will be unable to decipher the source of the cautionary message and thereby be frustrated in electoral efforts to hold the government accountable for its speech.

Predatory lenders will perhaps argue that the fact that warnings are displayed on private property precludes application of the government speech doctrine.[312] However, nothing in the Supreme Court's jurisprudence on government speech points to the physical location of the speech as dispositive. Rather, the Court has focused on the government's control of the message and final approval of content as the defining characteristics of government speech. Indeed, in *Johanns*, the Court found that the beef

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310. Downs v. L.A. Unified Sch. Dist., 228 F.3d 1003, 1012 (9th Cir. 2000).

311. R.J. Reynolds Tobacco Co. v. Shewry, 423 F.3d 906, 920 (9th Cir. 2005).

312. For those local governments unwilling to risk a First Amendment challenge, another policy option would be simply installing government created, owned, and maintained warning signs as close as possible to predatory lending locations. Most American cities and counties retain ownership of a small strip of land separating public roads from merchants' private property. Such a strategy would be the surest ordinance to survive constitutional challenge because it would avoid the use of any private action or property. Moreover, the cost of designing, installing, and maintaining warning signs could be raised from revenue generated through predatory lending permit fees. The mere fact that predatory lenders would have to pay for government warning signs would not detract from the constitutionality of the ordinance because "compelled funding of government speech does not alone raise First Amendment concerns." Johanns v. Livestock Mktg. Ass'n, 554 U.S. 550, 559 (2005). Moreover, this analysis is altogether unaffected by whether the funds for the warning signs are "raised by general taxes or through a targeted assessment." *Id.* at 562. "Citizens may challenge compelled support of private speech, but have no First Amendment right not to fund government speech. And that is no less true when the funding is achieved through targeted assessments devoted exclusively to the program to which the assessed citizens object." *Id.*

advertising campaign was government speech even though the advertisements were produced by marketing firms on private property, broadcast from private television and radio stations, and viewed in private homes and private businesses. The proposed ordinance's use of existing signage is best viewed from a constitutional perspective as government speech that "merely . . . solicits assistance from nongovernmental sources."[313] If adopted, courts should view the proposed ordinance "as an avenue for the representation of citizens' higher-minded desires even when as consumers they act with perhaps lower-minded motives."[314]

2. The Compelled Commercial Speech Doctrine

Even if the courts somehow decide that the proposed local government signs are private speech, the ordinance is nevertheless likely an example of constitutionally permissible compelled commercial speech. The core purpose of freedom of speech is to "assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people."[315] In furtherance of this purpose, the Supreme Court has most closely scrutinized what Robert Post has called "public discourse," the nature of which is "to ensure that a democratic state remains responsive to the views of its citizens."[316] While commercial speech also receives constitutional protection, the Court less closely scrutinizes this form of expression.[317]

Although the Court has had difficulty articulating the boundary between public discourse and commercial speech, in the seminal case of *Central Hudson Gas & Electric Corp. v. Public Service Commission*, the Supreme Court defined commercial speech as an

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313. *Id.*

314. Abner S. Greene, *Government Speech on Unsettled Issues,* 69 FORDHAM L. REV. 1667, 1683–84 (2001).

315. Roth v. United States, 354 U.S. 476, 484 (1957).

316. Robert Post, *The Constitutional Status of Commercial Speech,* 48 UCLA L. Rev. 1, 4 (2000).

317. *See* Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 562–63 (1980) ("The Constitution . . . accords a lesser protection to commercial speech than to other constitutionally guaranteed expression.").

"expression related solely to the economic interests of the speaker and its audience."[318] At other times, the Court has pointed to "speech that *proposes* a commercial transaction" as the hallmark of commercial expression.[319] Additionally, other cases have pointed to speech constituting an advertisement, speech that refers to a product or service, and economically motivated speech as indicative characteristics of commercial expression.[320] Despite these attempts at defining commercial speech, this category of First Amendment analysis has been controversial and, in the view of some, inconsistent.[321]

Nevertheless, the Supreme Court has tolerated more aggressive government regulation of commercial speech for at least two reasons:

> First, commercial speakers have extensive knowledge of both the market and their products. Thus, they are well situated to evaluate the accuracy of their messages and the lawfulness of the underlying activity. In addition, commercial speech, the offspring of economic self-interest, is a hardy breed of expression that is not particularly susceptible to being crushed by overbroad regulation.[322]

Furthermore, government action that merely compels speech, such as warnings or disclosures, receives less constitutional scrutiny than

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318. *Id.* at 561.

319. City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 423 (1993) (quoting Bd. of Trs. of the State Univ. of N.Y. v. Fox, 492 U.S. 469, 482 (1989)).

320. Bolger v. Youngs Drug Prods. Corp., 463 U.S. 60, 66–67 (1983); *see also* Jennifer L. Pomeranz, *Compelled Speech Under the Commercial Speech Doctrine: The Case of Menu Label Laws*, 12 J. OF HEALTH CARE L. & POL'Y 159, 168 (2009).

321. *See* Post, *supra* note 316, at 2 (explaining that commercial speech doctrine is "a notoriously unstable and contentious domain of First Amendment jurisprudence"). Former Chief Justice Rehnquist notably argued that commercial speech ought to receive no constitutional protection at all. Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 598–99 (1980) (Rehnquist, C.J., dissenting). Many scholars have agreed. *See* Akhil Reed Amar, *Intratextualism*, 112 HARV. L. REV. 747, 812–18 (1999); C. Edwin Baker, *Commercial Speech: A Problem in the Theory of Freedom,* 62 IOWA L. REV. 1, 3 (1976); Lillian R. BeVier, *The First Amendment and Political Speech: An Inquiry into the Substance and Limits of Principle,* 30 STAN. L. REV. 299, 352–55 (1978).

322. *Cent. Hudson*, 447 U.S. at 564 n.6.

restrictions of speech.[323] The Supreme Court has explained that less constitutional scrutiny is appropriate "[w]hen a State regulates commercial messages to protect consumers from misleading, deceptive, or aggressive sales practices, or requires the disclosure of beneficial consumer information, [because] the purpose of its regulation is consistent with the reasons for according constitutional protection to commercial speech."[324] The Supreme Court has not viewed the withholding of commercial information—that is, the right not to speak—as a fundamental right when a commercial speaker is marketing her services.[325] As the Second Circuit has stated, in contrast to restrictions of speech, "disclosure furthers, rather than hinders, the First Amendment goal of the discovery of truth and contributes to the efficiency of the 'marketplace of ideas.'"[326] Accordingly, "less exacting scrutiny is required than where truthful, nonmisleading commercial speech is restricted."[327] In sum, the First Amendment is satisfied "as long as disclosure requirements are reasonably related to the State's interest in preventing deception of consumers."[328] The majority in *Zauderer v. Office of Disciplinary Counsel*[329] explained that "in virtually all our commercial speech decisions to date, we have emphasized that

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323. *See* 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 501 (1996) (stating that warnings and disclosures receive "less than strict review").

324. *Id.*; *see also* Nat'l Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 113–14 (2d Cir. 2001); *see, e.g.*, 2 U.S.C. § 434 (2006) (reporting of federal election campaign contributions); 15 U.S.C. § 781 (2006) (securities disclosures); 15 U.S.C. § 1333 (2006) (tobacco labeling); 21 U.S.C. § 343(q)(1) (2006) (nutritional labeling); 33 U.S.C. §1318 (2006) (reporting of pollutant concentrations in discharges to water); 42 U.S.C. §11023 (reporting of releases of toxic substances); 21 C.F.R. § 202.1 (2011) (disclosures in prescription drug advertisements); 29 C.F.R. §1910.1200 (2011) (posting notification of workplace hazards).

325. *See* Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 n.14 (1985) ("The right of a commercial speaker not to divulge accurate information regarding his services is not . . . a fundamental right.").

326. *Nat'l Elec. Mfrs. Ass'n*, 272 F.3d at 114.

327. *Id.*; *see also* Riley v. Nat'l Fed'n of the Blind of N.C., 487 U.S. 781, 769 n.9 (1988) (stating that "[p]urely commercial speech is more susceptible to compelled disclosure requirements" than is personal or political speech).

328. *Zauderer*, 471 U.S. at 651; *see also* Milavetz, Gallop & Milavetz, P.A. v. United States, 130 S.Ct. 1324, 1339 (2010) (stating that when the government "impose[s] a disclosure requirement rather than an affirmative limitation on speech . . . the less exacting scrutiny described in *Zauderer* . . . governs").

329. *Zauderer*, 471 U.S. at 626.

because disclosure requirements trench much more narrowly on an advertiser's interests than do flat prohibitions on speech, warnings or disclaimers might be appropriately required in order to dissipate the possibility of consumer confusion or deception."[330] In applying these constitutional principles, courts have upheld "[i]nnumerable federal and state regulatory programs [that] require the disclosure of product and other commercial information."[331]

The proposed predatory-lender-warning ordinance is properly viewed by courts as a constitutionally permissible warning requirement. Unlike, for example, signs and billboards used in political election campaigns, the signs outside payday and car-title lending locations are displayed entirely for commercial purposes. They are designed to solicit and encourage customers to borrow money. Moreover, the cautionary signage ordinance is itself designed to provide warning information to citizens who contemplate engaging in these entirely private transactions. The ordinance's warning requirement does not affect how people interact with the state, nor does it affect the communication associated with lenders' personal affairs. The ordinance also does not interfere with the relationship between borrowers and predatory lenders. Lenders remain free to, for example, charge ruinous interest rates to poor families. Moreover, the ordinance does not attempt to prohibit or restrict any speech by predatory lenders.[332] Unlike many laws, such as advertising bans, the ordinance does not limit any speech by anyone. Rather, it merely adds a cautionary note authored by the government as advice to borrowers of the significant risks of high interest rate loans. Notwithstanding the warning requirement, predatory lenders would remain free to continue advertising their

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330. *Id.* at 651 (citations, ellipses, and original alterations omitted).

331. Nat'l Elec. Mfrs. Ass'n v. Sorrell, 272 F.3d 104, 116 (2d Cir. 2001); *see also* Commonwealth Brands, Inc. v. United States, 678 F. Supp. 2d 512, 532 (W.D. Ky. 2010) (upholding the Family Smoking Prevention and Tobacco Control Act's requirement that cigarette packages contain warnings).

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

services in any non-deceptive way they choose. Nothing in the proposed ordinance requires lenders to repeat an objectionable message out of their own mouths.[333] Indeed, predatory lenders could counteract the local government's warning within their store signage itself. Given the triple-digit interest rate profit incentives of predatory lenders, we should expect this type of counteractive speech to be just the sort of "hardy breed of expression" that courts need not be overly concerned with stifling.[334] The consumer-protection-oriented nature of the ordinance is squarely within the policy goals at the heart of the subordinate constitutional protection of commercial speech.

The proposed ordinance is reasonably designed to counteract the confusing and deceptive speech of predatory lenders. As Professor Post has observed, the Supreme Court has deployed weaker constitutional protection in "social settings that . . . involve persons who are deemed dependent, vulnerable, or not fully rational."[335] Part III of this Article sets out empirical evidence of common behavioral patterns that inhibit the ability of borrowers to make rational and fully informed decisions in this market. It is reasonable for local governments to conclude that a provocative and prominent warning is needed to counteract the ability of predatory lenders to systematically manipulate borrowers' less than fully rational behavior. Local governments are on a firm empirical foundation in believing that borrowers are unrealistically optimistic about their ability to repay high-cost debts that are aggressively marketed by predatory lenders.[336] At the most basic level, the very names of many leading lenders in this market are, arguably, misleading. Many lenders have names emphasizing speed, convenience, and ease of access. Examples of small loan chains with this type of brand identity include: ACE Cash Express, Cash Loans Now, Cash N Run, Check 'n' Go, EZCash, FastBuck$,

333. *See* W. Va. Bd. of Educ. v. Barnette, 319 U.S. 624, 632 (1943) (finding that the government may not compel children, contrary to their conscience, to salute the American flag).

334. Proctor & Gamble Co. v. Amway Corp., 242 F.3d 539, 549 n.16 (5th Cir. 2001) (quoting Cent. Hudson Gas & Electric Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 564 n.6 (1980)).

335. Post, *supra* note 316, at 4.

336. *See supra* notes 67–90 and accompanying text.

FastCash4You, Money Now, Quick Cash Financial Services, and SpeedyCash. It is not a coincidence that all of these brands emphasize "cash now" instead of "crushing interest payments later." Local government leaders would be reasonable in finding that many borrowers would benefit from a strong cautionary message because of borrowers' tendency to unwisely discount the value of future wealth and to exhibit distress-induced, abbreviated reasoning patterns.

Moreover, local governments could reasonably conclude that many borrowers have great difficulty in processing and comparing even basic financial and legal information necessary to compare value in consumer finance.[337] While payday and car-title lenders argue their contracts are simple, their contracts often impose many contingent and confusing fees and practices including "default rates," "service charges," "insufficient funds fees," "returned check fees," "collection costs," "late fees," "renewal fees," "court costs," "process service fees," "filling fees," and "attorneys' fees."[338] For the millions of Americans who lack even basic qualitative and quantitative literacy, these contracts are complicated and difficult to compare. Because default is common in the industry, these difficult-to-compare contingent fees are likely to have a greater effect on true costs in comparison to more mainstream financial products.

Many borrowers have virtually no incentive to comparison-shop because they realize that they will not be able to spot the various tricks and traps predatory lenders lay in the inscrutable boilerplate legal provisions that accompany even relatively simple loans. A person of minimal quantitative and legal literacy may *rationally* recognize that the transactional costs of identifying which lenders have hidden tricks and traps within their adhesive boilerplate dwarf the potential utility from what may be a futile exercise in shopping. In a heterogeneously segmented market, there is no guarantee that *any* lender will offer a credit-impaired borrower better terms, preferring to compete through aggressive collection practices instead of low, transparent pricing. Moreover, borrowers' perception of the incentive to incur shopping costs may be informed by the fact

337. *See supra* notes 91–114 and accompanying text.

338. All fees are taken from sample payday loan contracts on file with the Washington and Lee Law Review.

that in many consumer contexts, the law allows businesses to unilaterally change the terms of a consumer's deal after the fact anyway.[339] Even rational borrowers should discount the prospective benefit of shopping based on the realization that they have a very minimal chance of gaining access to counsel or a fair day in court to enforce those provisions of the agreement that might actually favor them.[340]

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339. *See* Regulation Z, 12 C.F.R. § 226.9(c)(1) (2010) (describing when a creditor is required to give notice of changes that the creditor makes to a home-equity plan); Hill v. Gateway 2000, Inc., 105 F.3d 1147, 1149 (7th Cir. 1997) (finding that a consumer is bound by terms received after payment if the consumer does not return the product); Alces & Greenfield, *supra* note 12, at 1145 ("Use of contract provisions that authorize the dominant party to change the terms of the contract at will are omnipresent in a wide range of contracts for credit and services."); William H. Lawrence, *Rolling Contracts Rolling Over Contract Law*, 41 SAN DIEGO L. REV 1099, 1109 (2004) ("[T]he deal [in *Hill*] had been closed in commercial understanding and the vendor subsequently sought to establish further terms to an existing contract.").

340. *Compare* DEBORAH L. RHODE, ACCESS TO JUSTICE 3 (2004) ("[A]bout four-fifths of the civil legal needs of the poor, and two- to three-fifths of the needs of middle-income individuals, remain unmet."), CHRISTOPHER E. SMITH, COURTS AND THE POOR 11 (1991) (discussing wealth discrimination in the court system), Stephen B. Bright, *Legal Representation for the Poor: Can Society Afford This Much Injustice?*, 75 MO. L. REV. 683, 683 (2010) (describing "equal justice for all" as "an aspiration, not reality"), Russell Engler, *Connecting Self-Representation to Civil* Gideon*: What Existing Data Reveal About When Counsel is Most Needed*, 37 FORDHAM URB. L.J. 37, 92 (2010) (arguing for an expanded right to civil counsel), Russell Engler, *Pursuing Access to Justice and Civil Right to Counsel in a Time of Economic Crisis*, 15 ROGER WILLIAMS U. L. REV. 472, 498 (2010) ("Tabling the concept of an expanded right to counsel turns as essential component of a fair judicial system into a luxury item."), Jona Goldschmidt, *The Pro Se Litigant's Struggle for Access to Justice,* 40 FAM. CT. REV. 36, 37 (2002) ("[P]ro se litigants . . . often encounter bench and bar resistence."), Robert A. Katzmann, *The Legal Profession and the Unmet Needs of the Immigrant Poor*, 21 GEO. J. LEGAL ETHICS 3, 3 (2008) ("All too often immigrants are deprived of adequate legal representation . . . ."), Gene R. Nichol Jr., *Judicial Abdication and Equal Access to the Civil Justice System*, CASE WES. RES. L. REV. 325, 327 (2010) (characterizing "our strongest and most pervasive transgression against access and equality" as the poor's "exclusion from the effective use of our civil justice system"), *and* LEGAL SERVS. CORP., DOCUMENTING THE JUSTICE GAP IN AMERICA: THE CURRENT UNMET CIVIL LEGAL NEEDS OF LOW-INCOME AMERICANS 27–28 (2009), *available at* http://www.lsc.gov/sites/default/files/LSC/pdfs/documenting_the_justice_gap_in_america_2009.pdf (describing the importance of providing the poor with civil legal assistance), *with* Gideon v. Wainwright, 372 U.S. 335, 344–45 (1963) ("The right to be heard would be, in many cases, of little avail if it did not comprehend the right to be heard by counsel. Even the intelligent and educated layman has small and sometimes no skill in the science

Predatory lenders' best argument will be that the label "predatory" is so pejorative that it cannot be characterized as commercial speech and is therefore subject to strict scrutiny. Although a few lower courts have attempted to argue that the *Zauderer* standard of scrutiny can only be applied to "uncontroversial information,"[341] the Supreme Court has primarily focused on whether warnings are accurate statements.[342] Thus the Court insists: "The right of a commercial speaker not to divulge accurate information regarding his services is not such a fundamental right."[343] Local governments should argue that the word is an accurate description given the abusive commercial practices prevalent in this industry. The word "predatory" is commonly defined as "inclined . . . to injure or exploit others for personal gain or profit."[344] At least eleven different federal regulatory agencies have publicly used the term "predatory" to describe some form of abusive lending.[345] The label is commonly used by scholars and the press in describing lending regulated by the ordinance.[346] Indeed, the word "predatory" has only come into common usage in recent years as a substitute for the adjective "criminal," which had been, and still is, used in many states to describe these loans for hundreds of years. That Congress and many states have used a 45% interest rate as a criterion in establishing a

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of law . . . . Left without the aid of counsel . . . . [h]e lacks both the skill and knowledge adequately to prepare his defense, even though he have a perfect one." (quoting Powell v. Alabama, 287 U.S. 45, 68–69 (1932))).

341. *See* R.J. Reynolds Tobacco Co. v. FDA, No.11-1482, 2011 WL 5307391, at *6 (D.D.C. Nov. 7, 2011) (describing "the *Zauderer* exception for purely factual and uncontroversial information").

342. Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 651 (1985) ("[W]e hold that an advertiser's rights are adequately protected as long as disclosure requirements are reasonably related to the State's interest in preventing the deception of consumers.").

343. *Id.*

344. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 977 (11th ed. 2011).

345. *See* Peterson, *supra* note 31, at 5 (collecting examples).

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

loan's criminality is evidence that the term "predatory" is factual.[347] While the term "predatory" may exist at the outer bounds of commercial speech, it is factually appropriate for commerce at the outer bounds of legally acceptable behavior.

While criminality is not a standard courts use to judge the constitutionality of compelled speech, it would nevertheless be an odd constitution that allows government to incarcerate people to prevent predatory lending but forbids government from deploying strongly worded warnings. Where a business solicits consumers to engage in a transaction that has been widely treated as criminally abusive for nearly three hundred years, the Constitution ought not to require only uselessly insipid, wishy-washy, and milquetoast warnings. The Constitution does not prevent the government from using "plain English" to warn vulnerable citizens about financial predators.[348] The judicial preference for decorum is not a constitutional requirement. Recognizing this point, former Chief Justice Rehnquist explained that if courts hold otherwise, "[l]oan sharks might well choose States with unregulated small loan industries, luring the unwary with immune commercial advertisements."[349] Surely if the Chief Justice of the Supreme Court can label high-cost, small-loan lenders "loan sharks," local governments are on a firm rhetorical footing with the relatively restrained label of "predatory lender." As the former Chief Justice

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347. *See infra* Part V.A and accompanying text.

348. *See* Hersh v. United States, 553 F.3d 743, 767 (5th Cir. 2008) (upholding a congressional statute requiring that attorneys describe themselves as "debt relief agencies"); *see also* R.J. Reynolds Tobacco Co. v. Shewry, 423 F.3d 906, 911–12 (9th Cir. 2005) (upholding a cigarette surtax funded public advertising campaign that attacked "not 'the desirability of a product but . . . the moral character of [the] industry, accusing it of hypocrisy, cynicism and duplicity"); Commonwealth Brands, Inc. v. United States, 678 F. Supp. 2d 512, 530 (W.D. Ky. 2010) (rejecting application of strict scrutiny to tobacco industry's First Amendment challenge to FDA graphic cigarette warning labels). *But see* R.J. Reynolds Tobacco Company v. FDA, No. 11-1482, 2011 WL 5307391, at *6–8 (D.D.C. Nov. 7, 2011) (applying strict scrutiny to strike down the FDA's graphic cigarette warning labels).

349. Bigelow v. Virginia, 421 U.S. 809, 835–36 (1975) (Rehnquist, J., dissenting). Moreover, a search of Westlaw's Supreme Court Decisions database indicates that the United States Supreme Court has used the term "predatory" in various criminal and civil contexts in at least 109 different published opinions.

seems to have recognized, it is factually accurate to characterize lions, tigers, bears, and loan sharks as predatory.

VI. Conclusion

This Article has explored local government ordinances and resolutions that attempt to inhibit predatory lending within their communities. A growing trend of local government action has emerged following the failure of federal and state leaders to provide effective consumer protection laws. This vacuum in leadership on small, high-cost loans has developed despite the great majority of Americans who support banning predatory loans. Federal and state preemption of local financial regulation have left local governments with limited authority to act on their constituents' wishes. However, because local governments traditionally have had broad authority to regulate merchants' exterior signage, this Article suggests using that power to protect families from predatory loans. In particular, this Article proposes a model ordinance requiring that lenders offering loans with APRs in excess of 45% display a cautionary message that reads "Warning: Predatory Lender," on their street, storefront, and other on-premises exterior signs. While these signage requirements are in some respects unusual, this flows from the great disparity in the wishes of the public and the law as it has come to be controlled by the powerful business interests that exert pressure on key financial services committees in state legislatures and Congress. Providing a strongly worded message of caution on exterior signs to warn predatory loan borrowers would allow local governments to seize the initiative to help vulnerable families. Given the strong empirical, historical, and moral evidence suggesting that predatory small loans are destructive for borrowers, their families, and our communities, local government leaders should use their offices to protect the citizens who elected them.

Appendix A. Model Predatory Small Loan Ordinance

[Insert Jurisdiction] ORDINANCE No. ____

PREDATORY SMALL LOAN ORDINANCE

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

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

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

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

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

WHEREAS, predatory lending locations increase crime; and

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

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

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

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

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

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

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Section 500. Licensing

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Section 100. Title for Citation

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

Section 200. Legislative Findings

The [insert jurisdiction] Council finds as follows:

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

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

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

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

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

(f) Predatory lending locations increase crime; and

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

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

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

Official Comments:

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

Section 300. Definitions

As used in this Chapter unless the context requires otherwise:

(a) "Annual Percentage Rate" shall be defined in accordance with federal law.

(b) "Director" means the Director of the [insert appropriate administrative department].

(c) "Predatory Lender" means any person or entity that lends, brokers, or in any way extends a predatory small loan.

(d) "Predatory Lending Facility" means any location where a predatory lender conducts business.

(e) "Predatory Small Loan" means an extension of credit made at an annual percentage rate in excess of 45%.

(f) "Warning Sign" means a sign required by this ordinance that includes the language "[INSERT JURISDICTION] WARNING: PREDATORY LENDER."

Official Comments:

1. Subparagraph (a) and (e), in combination with Section 600, indicate that this ordinance applies to all lenders who make extensions of credit in excess of an annual percentage rate of 45%. Since this ordinance defers to federal law on the definition of an annual percentage rate, the scope of this ordinance is coextensive with federal law as it is currently articulated in the Truth in Lending Act and Regulation Z. Insofar as a financial service does not carry an annual percentage rate under federal law, the signage requirements of this ordinance would not apply to that transaction. However, if federal law characterizes a service as imposing an annual percentage rate, the service is within the scope of this ordinance at the point that the rate exceeds 45%.

Section 400. Administrative Authority

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

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

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

(1) At the public hearing, the Director or designee shall hear oral and written testimony concerning the proposed rule. The Director shall have the power to establish and limit the matters

to be considered at the hearing, to prescribe procedures for the conduct of the hearings, to hear evidence, and to preserve order.

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

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

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

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

Section 500. Licensing

(a) Within 90 days of the effective date of the ordinance enacted in this Chapter, any predatory lender operating in [insert jurisdiction] shall apply for and obtain a permit to operate as a predatory lender. Permits shall be required for each location a lender operates in [insert jurisdiction] and shall be renewed annually. The application shall be in a form to be determined by the Director or the Director's designee. No person shall operate a predatory lending business located in [insert jurisdiction] without a current permit to do business issued by [insert jurisdiction].

(b) The annual permit fee for each location shall be $10,000 in the first year following enactment of this ordinance. In each subsequent year following enactment of this ordinance, the Director shall adjust the annual permit fee to account for inflation or deflation based on the Consumer Price Index as calculated by the United States Department of Labor Bureau of Labor Statistics or based on another comparable measure of price change designated by the Director.

(c) Predatory lending permits shall be required in addition to the [insert jurisdiction] business license required by section [insert appropriate code section] of the [insert jurisdiction] Code.

Official Comments:

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

Section 600. Signage

(a) It is unlawful and a violation of this code for any predatory lender to operate a predatory lending facility, unless the premises where the predatory lending facility is operated displays exterior signs conforming to the requirements of this section.

(b) All exterior signs displayed at the business location of a predatory lender shall be modified to include the [insert jurisdiction] disclosure statement: "[INSERT JURISDICTION] WARNING: PREDATORY LENDER." The [insert jurisdiction] disclosure statement shall substantially occupy 33% of the spatial area on all signs governed by this section. The 33% area allocated for the disclosure statement shall be composed of a black, Arial, all-capitals text on a white background.

(c) Predatory lenders operating within [insert jurisdiction] shall obtain and display official [insert jurisdiction] predatory lending door signs on all exterior doors at any predatory lending facility.

(d) The Director shall design and distribute to predatory lending facility permit holders official [insert jurisdiction] predatory lending door signs. The predatory lending door sign shall be designed to be visible by persons entering the predatory lending facility. The predatory lending door sign shall be designed to substantially occupy the entire spatial area of exterior doors at the predatory lending facility. The director shall, in his or her discretion, have the authority to provide different types of official predatory lending door signs to accommodate mounting such signs on different types of exterior doors, so long as these variations are otherwise in compliance with the requirements of this Section.

(e) Official [insert jurisdiction] predatory lending door signs shall have black, Arial, all-capitals text with a white background. Such door signs shall display the disclosure statement: "[INSERT

JURISDICTION] WARNING: PREDATORY LENDER." In addition, the official door sign shall include the following explanatory comment: "[Insert jurisdiction] has determined that this facility engages in predatory lending. [Insert jurisdiction] has required this lender to display consumer protection warnings. This predatory lending facility lends at interest rates above 45%. These loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship."

(f) All signs required by this Section shall display the [insert jurisdiction] official seal.

Official Comments:

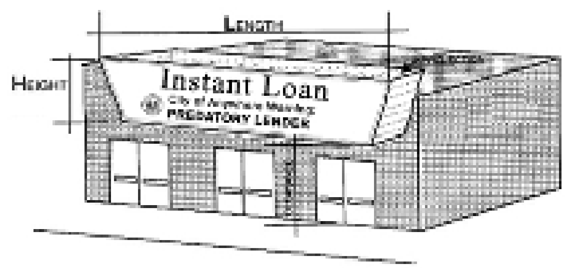
1. The purpose of this Section is to warn consumers about the risks associated with small predatory loans. Many predatory loan borrowers lack bargaining power and financial experience and have difficulty evaluating the risks, prices, and consequences associated with high-costs debt. Moreover, many predatory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

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

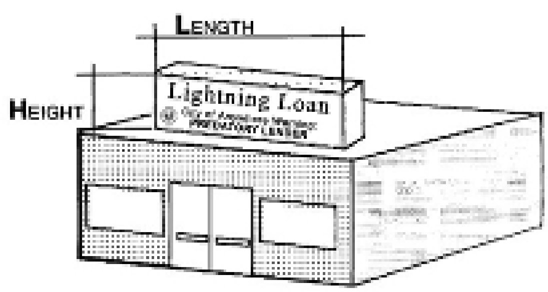
3. Predatory lending facilities may have various types of pre-existing signage. Subsection (b) does not require a single authorized sign design, except as specified by the requirements of this Section. To assist predatory lenders in complying with subsection (b), this comment includes several illustrative examples:

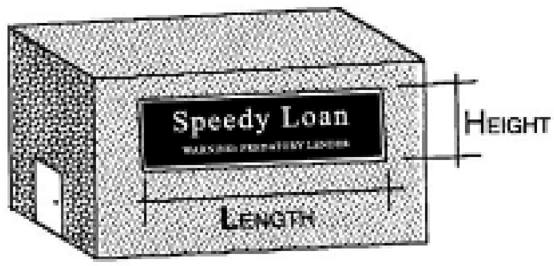
a. Monument sign:

b. Marquee sign:

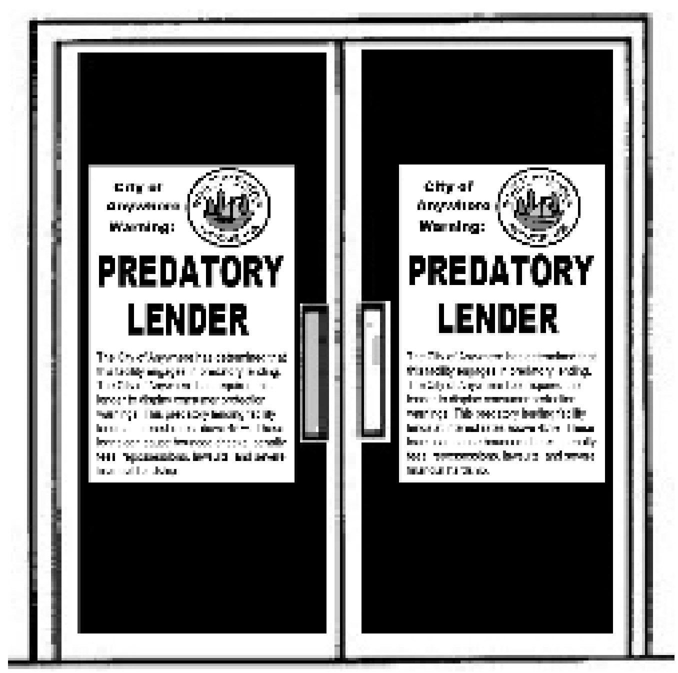


c. Roof sign:





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



Section 700. Enforcement

(a) The remedies provided herein are cumulative and supplementary and apply to licensees and unlicensed persons to whom this Ordinance applies, even when they failed to obtain a permit as required.

(b) The Director shall have the authority to bring suit to enforce this Ordinance. A predatory lender found in violation of this Ordinance shall be liable for a statutory penalty of $10,000 per month per signage violation, together with any and all costs and attorney fees incurred by [insert jurisdiction] in enforcing this Ordinance.

(c) Any borrower who obtains a loan from a predatory lender in violation of this ordinance shall have the right to enforce the provision of this Ordinance through an individual or class-representative lawsuit. A predatory lender found to have violated this Ordinance shall be liable to each borrower for actual, consequential, and statutory damages of $2,000 for each signage violation, together with costs and reasonable attorney fees, as well as any appropriate injunctive or other equitable relief. The remedies provided in this Section are not intended to be the exclusive remedies available to borrowers nor to require borrowers to exhaust any administrative remedies provided by contract or any other applicable law.

(d) Any predatory lending facility operated, conducted, or maintained in violation of this Ordinance or any other federal or state law shall be, and hereby is, declared to be unlawful and a public nuisance. The Director may, in addition to or in lieu of any other remedies set forth in this Ordinance, commence an action to enjoin, remove, or abate such nuisance in the manner provided by law and shall take such other steps and apply to such court or courts as may have jurisdiction to grant such relief.

(e) In each subsequent year following enactment of this Ordinance, the Director shall adjust the statutory penalty and damage provisions of subsections (b) and (c) to account for inflation or deflation based on the Consumer Price Index as calculated by the United States Department of Labor Bureau of Labor Statistics or based on another comparable measure of price change designated by the Director.

Section 800. Severability

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