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# A Noose Around the Neck: Preventing Abusive Payday Lending Practices and Promoting Lower Cost Alternatives

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**A NOOSE AROUND THE NECK: PREVENTING ABUSIVE  
PAYDAY LENDING PRACTICES AND PROMOTING  
LOWER COST ALTERNATIVES**

Patrick L. Hayes<sup>†</sup>

I. INTRODUCTION.....	1134
II. PAYDAY LENDING IN THE UNITED STATES.....	1136
A. <i>Characteristics of a Payday Loan and the Industry's         Expansion in the United States</i> .....	1136
1. <i>The Characteristics of Payday Loans</i> .....	1136
2. <i>The Expansion of the Payday Lending Industry in             America</i> .....	1138
B. <i>Demographics of a Typical Payday Loan Consumer</i> .....	1139
C. <i>The Troublesome Features of Payday Loans</i> .....	1142
1. <i>Triple-Digit Interest Rates</i> .....	1142
2. <i>The Debt Treadmill</i> .....	1142
3. <i>Coercive Debt Collection Practices</i> .....	1143
III. MINNESOTA STATE REGULATION OF PAYDAY LENDERS.....	1144
A. <i>Minnesota Consumer Small Loan Statute</i> .....	1144
B. <i>Weaknesses</i> .....	1146
IV. STRENGTHENING MINNESOTA'S CONSUMER SMALL LOAN STATUTE AND DEVELOPING WAYS TO PREVENT ABUSIVE, HIGH-RATE PAYDAY LENDERS.....	1147
A. <i>Strengthening the Minnesota Statute</i> .....	1147
B. <i>Litigation</i> .....	1154
C. <i>Market Pressure</i> .....	1157
V. CONCLUSION.....	1160

I. INTRODUCTION

At the age of nineteen, Miasha Thomas bought her first house in Saint Paul, Minnesota.<sup>1</sup> Her earnings from a mail-sorting job

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1. Ron Nixon et al., *Borrowing Trouble: A Star Tribune Special Report: Costly Loans Turn Payday Into Debt Day*, STAR TRIB. (Minneapolis), Aug. 15, 2004, at 1A.

barely covered her mortgage and modest living expenses.<sup>2</sup> Without warning, one day she lost her job.<sup>3</sup> What she thought would be a temporary setback extended into a long-term struggle to make ends meet.<sup>4</sup> So, one day, she gave into temptation and walked into a store with a yellow sign advertising payday loans.<sup>5</sup> She asked for a \$250 loan against her next paycheck.<sup>6</sup> To qualify for the loan, Thomas only needed an I.D., confirmation of a job, and a checking account.<sup>7</sup> The lender charged her \$22.50 in fees and interest—equivalent to a 469% annual percentage rate.<sup>8</sup>

Thomas returned a few weeks later to borrow \$350 and a week later another \$350, and yet another \$350.<sup>9</sup> She persuaded her parents to take out payday loans for her.<sup>10</sup> During a three-year period, Thomas incurred more than \$2,100 in fees.<sup>11</sup> Exorbitant fees and interest rates eventually forced her to sell her home.<sup>12</sup>

Payday lenders promise a lifeline but are actually a noose around the neck for Thomas and thousands of Minnesota's low-income residents.<sup>13</sup> A number of financial businesses have profited during the past decade by targeting low-income populations who struggle from paycheck to paycheck to make ends meet and have been denied access to mainstream financial institutions.<sup>14</sup> Deregulation spawned the growth of these industries that prey upon the increased number of people with bad credit, rising levels of personal debt, and a growing immigrant population.<sup>15</sup> Payday lending is not only the fastest growing industry in the finance sector,<sup>16</sup> it is one of the fastest growing industries in America.<sup>17</sup>

This article outlines the problems associated with payday lending and Minnesota's attempt to regulate the industry, and then

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2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. Lisa Blaylock Moss, Commentary, *Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 ALA. L. REV. 1725, 1731 (2000).

recommends ways Minnesota can strengthen its regulation of the industry and how other measures could prevent abusive payday lending. Part II discusses the payday loans in detail. Part II.A discusses the characteristics of payday loans and the industry's expansion in the United States. Part II.B examines the demographics of a payday loan consumer. Part II.C discusses the troublesome features of payday loans. Part II involves a lengthy, but essential discussion regarding the payday lending industries. This extended discussion complements an intention to underscore the predatory nature of the payday loan industry and the need for reform. Part III describes Minnesota's attempt to regulate the payday lending industry and its shortcomings. Part IV proposes ways to curb the abusive payday loan practices. Part IV.A specifies ways to strengthen the current Minnesota Small Loan Consumer Statute. Part IV.B details another method for preventing unfair payday lending practices through litigation. Finally, Part IV.C identifies ways in which banks and credit unions could provide affordable, yet profitable, alternatives to payday loans.

## II. PAYDAY LENDING IN THE UNITED STATES

### A. *Characteristics of a Payday Loan and the Industry's Expansion in the United States*

#### 1. *The Characteristics of Payday Loans*

Payday lending is a component of the "alternative financial services" or "fringe banking" industry in the United States.<sup>18</sup> Many traditional loan providers abandoned the risky small-loan industry in favor of more profitable, larger loans, which had benefited from the deregulation of the banking industry and elimination of interest rate caps in the 1980s.<sup>19</sup> The fringe-banking industry filled the vacuum by promoting alternative financial services to consumers with poor credit ratings or low to moderate incomes.<sup>20</sup> Payday lending comprises an important part of the fringe-banking

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18. Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 591 (2000).

19. Moss, *supra* note 17, at 1732. See generally Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110 (2008) (discussing how state and federal deregulation paved the way for payday lending).

20. Drysdale & Keest, *supra* note 18, at 591.

industry by issuing small loans to high-risk consumers who lack access to mainstream financial institutions.<sup>21</sup> The loans are available at gas stations, pawn shops, convenience stores, ATMs, the Internet, and traditional payday loan stores.<sup>22</sup>

A payday lender makes short-term cash loans.<sup>23</sup> Generally, the payday loans have two-week terms and are for less than \$1,000.<sup>24</sup> In states that specifically permit payday lending, allowable loan amounts range from \$300 to \$1,000, with a common cap of \$500.<sup>25</sup> To get a payday loan, a consumer typically gives the payday lender a postdated check that includes the payday lender's fee.<sup>26</sup> The payday lender advances the amount of the check, excluding the fee in cash.<sup>27</sup> Other transactions use delayed automatic debit agreements as opposed to postdated checks.<sup>28</sup> The payday lender agrees to defer the deposit of the check or the automatic debit for an agreed-upon time, which generally is tied to coincide with the consumer's next payday, or sometimes for a period of time for up to a month.<sup>29</sup> The application process is highly streamlined, requires minimal credit criteria, and provides cash immediately.<sup>30</sup>

The process follows a typical pattern. The consumer gives a payday lender a \$115 check (\$100 for the loan amount and \$15 for the fee).<sup>31</sup> The consumer then receives \$100 in cash.<sup>32</sup> When the

21. Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 8 (2002).

22. STATE PUB. INTEREST RESEARCH GROUPS & CONSUMER FED'N OF AM., SHOW ME THE MONEY!: A SURVEY OF PAYDAY LENDERS AND REVIEW OF PAYDAY LENDER LOBBYING IN STATE LEGISLATURES 1 (2000), [http://www.uspirg.org/uploads/0J/JI/0JlXjotTQIpsOOhaP\\_dg/showmethemoneyfinal.PDF](http://www.uspirg.org/uploads/0J/JI/0JlXjotTQIpsOOhaP_dg/showmethemoneyfinal.PDF) [hereinafter SHOW ME THE MONEY!].

23. Drysdale & Keest, *supra* note 18, at 600.

24. *Id.* at 602.

25. Since 1997, the Consumer Federation of America, which monitors the payday lending industry, has published annual reports that include surveys of state laws applicable to payday lending. CONSUMER FED'N OF AM., SMALL DOLLAR LOAN PRODUCTS SCORECARD: STATUTORY BACKUP (2008), [http://www.consumerfed.org/pdfs/statutory\\_backup\\_08.pdf](http://www.consumerfed.org/pdfs/statutory_backup_08.pdf).

26. Drysdale & Keest, *supra* note 18, at 600–01.

27. *Id.* at 601.

28. *Id.*

29. *Id.*

30. SHEILA BAIR, ANNIE E. CASEY FOUND., LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 6 (2005), <http://www.aecf.org/upload/publicationfiles/fes3622h334.pdf>.

31. Drysdale & Keest, *supra* note 18, at 601.

32. *Id.* To qualify for a payday loan at an UnBank, a Minnesota payday lender, a consumer must be a Minnesota resident, eighteen years of age or older, and must have a proof of a current checking account (minimum of three months

payday loan comes due, the consumer can give the payday lender \$115 in cash or a money order to redeem the check and prevent the automatic debit, or the consumer can let the payday lender deposit the check or debit the account.<sup>33</sup>

## 2. *The Expansion of the Payday Lending Industry in America*

Payday lending began in 1993 in the United States when Check Into Cash, Inc. opened its first store in Tennessee.<sup>34</sup> The industry developed by exploiting the loopholes in usury laws that set ceilings on the rates charged for loans.<sup>35</sup> The industry promoted itself as a less costly and more desirable alternative to bank charges for insufficient fees, late charges on credit cards, or utility reconnect fees.<sup>36</sup> The industry maintained that it was not a loan but instead a form of check-cashing services or sale of a check.<sup>37</sup> Even if it was a loan, the industry maintained that small loan laws exempted the industry from state usury laws.<sup>38</sup> The industry grew as regulators and state legislatures sought ways to deal with reports of high-cost credit.<sup>39</sup> According to some reports, by May 2005 payday loan stores outnumbered McDonald's restaurants nationwide.<sup>40</sup>

By 2005, there were roughly 23,000 to 25,000 payday lenders located across the country that produced more than \$40 billion in loans.<sup>41</sup> The industry's growth is driven by its immense

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old), a checkbook, a current photo I.D., and a home phone number. UnBank, <http://www.unloan.com/HowItWorks.asp> (last visited Mar. 6, 2009).

33. Drysdale & Keest, *supra* note 18, at 601.

34. Scott Andrew Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. BANKING INST. 339, 339 nn.3-4 (2001). Based in Cleveland, Tennessee, Check Into Cash, Inc. opened its first outlet in 1993 and as of 2001 had more than three-hundred outlets in fifteen states. *Id.* at 339 n.4 (citing JERRY L. ROBINSON, STEPHENS INC., PAYDAY ADVANCE—THE FINAL INNINGS: STANDARDIZING THE APPROACH 3, 4 (Sept. 22, 2000)).

35. Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 964 (2008).

36. Cmty Fin. Servs. of Am., *Payday Advance: Fact vs. Fiction*, [http://www.cfsa.net/fact\\_vs\\_fiction.html](http://www.cfsa.net/fact_vs_fiction.html) (last visited Feb. 5, 2009).

37. *Cashback Catalog Sales, Inc. v. Price*, 102 F. Supp. 2d 1375, 1380-81 (S.D. Ga. 2000).

38. Spector, *supra* note 35, at 974.

39. *Id.*

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

41. Consumer Fed'n of Am., *PayDay Loan Consumer Information*, <http://www.paydayloaninfo.org/facts.cfm> (last visited Feb. 5, 2009).

profitability.<sup>42</sup> With 25,000 stores producing payday loans, the industry generates \$6.75 billion annually in fees alone.<sup>43</sup> The industry reports a return on investment of 24% and gross margins of 30% to 45% of annual revenue.<sup>44</sup> In comparison, banks that are not part of the fringe-banking sector average a 15% return on investments.<sup>45</sup> Advance America, the largest monoline<sup>46</sup> payday lender, generated \$630 billion in revenue in 2005, a 10.5% increase from the previous year.<sup>47</sup> Thus, payday loans produce exorbitant profit margins for lenders, thereby inducing rapid market growth.<sup>48</sup>

In Minnesota, the payday lending industry has grown significantly. The industry grew from five companies and \$33 million in loans in 1999 to twenty-four companies and \$58 million in loans in 2006.<sup>49</sup> From 1999 to 2006, Minnesota consumers took out about \$1 million payday loans for total of more than \$215 million.<sup>50</sup>

#### B. *Demographics of a Typical Payday Loan Consumer*

The payday lending industry intimates that it provides a valuable product to astute consumers.<sup>51</sup> Industry-sponsored surveys claim that more than half of payday loan consumers had family incomes between \$25,000 and \$50,000.<sup>52</sup> The same surveys stated

42. Michael Bertics, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 133, 136 (2005).

43. KATHLEEN E. KEEST & ELIZABETH RENUART, *THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES* § 7.5.5.2 (3d ed. 2005).

44. Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 150 (2004).

45. Bertics, *supra* note 42, at 144–45.

46. A monoline payday lender offers only payday loans as opposed to phone cards, checking cashing services, and title loans. BARR, *supra* note 30, at 6 n.1.

47. Kelly J. Noyes, Note, *Get Cash Until Payday! The Payday-Loan Problem in Wisconsin*, 2006 WIS. L. REV. 1627, 1632 (2006) (citing ADVANCE AM., CASH ADVANCE CTRS. INC., FORM 10K (ANNUAL REPORT) 47 (Mar. 16, 2006)).

48. See Bertics, *supra* note 42, at 141–42 (analyzing the principles that encourage new market entrants).

49. H.J. Cummins, *Legislators Seek to Curtail 'Payday Lending' Practices: The Industry Argues that the Proposed Legislation to Limit Interest Rates Would Effectively Put It Out of Business*, STAR TRIB. (Minneapolis), Feb. 24, 2008, at D1 (citing Minnesota Department of Commerce data analyzed by the Legal Services Advocacy Project).

50. *Id.*

51. Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 727 (2004).

52. NAT'L ENDOWMENT FOR FIN. EDUC. & CONSUMER FED'N OF AM., *THE DEBT CYCLE: USING PAYDAY LOANS TO MAKE ENDS MEET* 13 (2002), [http://www.nefe.org/Portals/0/NEFE\\_Files/Research%20and%20Strategy/Personal%20Finance%20Papers%20white%20papers/05Debt%20Cycle%20Using%2](http://www.nefe.org/Portals/0/NEFE_Files/Research%20and%20Strategy/Personal%20Finance%20Papers%20white%20papers/05Debt%20Cycle%20Using%2)

that 90% of payday lending consumers had a high school diploma, 56% had at least some college education, and that a typical payday lending consumer was a young female parent.<sup>53</sup> Another industry study suggested that most payday consumers fell within the lower range of \$25,000 and \$50,000 with 23% reporting incomes of less than \$25,000.<sup>54</sup> Yet another industry source described a typical payday loan consumer as “a responsible, hardworking middle class American” with an average annual income of \$33,000.<sup>55</sup> The same source claimed that one-third of these consumers owned their homes and that they all had regular sources of income.<sup>56</sup>

Yet, data from non-industry sources demonstrates that the payday lenders exploit individuals who lack access to credit alternatives or information that would permit comparison shopping.<sup>57</sup> One survey found that consumers were more often than not members of minority groups with a household income of less than \$25,000.<sup>58</sup> They possessed at best a high school or GED education, or more often less; were between eighteen and fifty-nine years old; and were single females with dependents.<sup>59</sup> The same survey stated that payday lenders target welfare to work women and considered them “a fertile market for payday lenders.”<sup>60</sup> Another

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0Payday%20Loans\_Feb02.pdf [hereinafter THE DEBT CYCLE]; OFFICE OF [MO.] STATE AUDITOR CLAIRE MCCASKILL, DIV. OF FIN. & REG. OF INSTANT LOAN INDUS., PERFORMANCE AUDIT 3 (2001), <http://auditor.mo.gov/press/2001-36.pdf>.

53. THE DEBT CYCLE, *supra* note 52, at 28–29.

54. GREGORY ELLIEHAUSEN, PH.D. & EDWARD C. LAWRENCE, PH.D. CREDIT RESEARCH CTR., PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CUSTOMER DEMAND 3 (2001), [http://www.cfsa.net/downloads/analysis\\_customer\\_demand.pdf](http://www.cfsa.net/downloads/analysis_customer_demand.pdf).

55. Schaaf, *supra* note 34, at 348 (quoting *Forum on Short-Term High Interest Paycheck Advances*, U.S. Senate Comm. on Governmental Affairs, at 2 (Dec. 15, 1999) (written testimony of Billy Webster, President, CFSA) (on file with N.C. Banking Inst.)).

56. *Id.* at 349.

57. Chin, *supra* note 51, at 727.

58. JEAN ANN FOX & EDMUND MIERZWINSKI, CONSUMER FED’N OF AM. & U.S. PUB. INTEREST RESEARCH GROUP, RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS, THE 2001 PAYDAY LENDER SURVEY AND REPORT (2001), <http://www.consumerfed.org/pdfs/paydayreport.pdf>.

59. *Id.*

60. *Id.* In 1996, President Clinton signed into law the Personal Responsibility and Work Opportunity Reconciliation Act (“PRWOR”), which implemented rigorous work requirements for welfare recipients. Pub. L. No. 104-192, 110 Stat. 2105 (1996). The intent of PRWOR was to move welfare recipients from welfare to work. Tammi D. Jackson, *Free Social Services: Where Do I Enroll? – The True Cost Welfare Recipients and Undocumented Immigrants Have on the U.S. Economy*, 13 PUB. INT. L. REP. 271, 273 (2008). Studies have shown that welfare to work women are a



study showed that racial motivations have spurred the industry's growth.<sup>61</sup> This study found that payday lenders were predominantly located in lower-income African-American neighborhoods and were scarcely represented in white neighborhoods with similar income levels.<sup>62</sup> Other state surveys found that the average payday loan consumer generated an annual income of \$25,000.<sup>63</sup> Furthermore, a disproportionate amount of payday lenders operate in six states that have a median income level below the national median.<sup>64</sup>

In Minnesota, payday lenders filled the vacuum left by the fifty-seven bank branches that have disappeared from the Twin Cities since 1996.<sup>65</sup> In Minnesota, 56% of the payday loans occur in the suburbs, with 27% in rural areas of Minnesota and 16% in Minneapolis and Saint Paul.<sup>66</sup> Moreover, data demonstrates that these payday lenders target low-income consumers.<sup>67</sup> A Minnesota resident has a higher probability of living within a half-mile of a payday lender based upon a lower median income level: \$15,000: 88%; \$30,000: 73%; \$45,000: 50%; \$60,000: 27%; \$75,000: 12%; \$90,000: 5%; and \$125,000: less than 1%.<sup>68</sup>

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particularly vulnerable group. See, e.g., Maria L. Imperial, *Self-Sufficiency and Safety: Welfare Reform for Victims of Domestic Violence*, 5 GEO. J. ON FIGHTING POV. 3, 10 (1997) (discussing studies that show over half of the women on welfare-to-work programs were victims of domestic abuse).

61. URIAH KING ET AL., CTR. FOR RESPONSIBLE LENDING, RACE MATTERS: THE CONCENTRATION OF PAYDAY LENDERS IN AFRICAN-AMERICAN NEIGHBORHOODS IN NORTH CAROLINA 2 (2005), [http://www.responsiblelending.org/pdfs/rr006-Race\\_Matters\\_Payday\\_in\\_NC-0305.pdf](http://www.responsiblelending.org/pdfs/rr006-Race_Matters_Payday_in_NC-0305.pdf).

62. *Id.*

63. Johnson, *supra* note 21, at 99. Illinois, Wisconsin, and California were included in these surveys. *Id.*

64. *Id.* The six states are Kentucky, Missouri, Mississippi, Tennessee, South Carolina, and North Carolina. *Id.* at 99 n.525. According to census data, the median household income in 2007 in the United States reached \$50,233. Press Release, U.S. Census Bureau News, Household Income Rises, Poverty Rate Unchanged, Number of Uninsured Down (Aug. 26, 2008), [http://www.census.gov/Press-Release/www/releases/archives/income\\_wealth/012528.html](http://www.census.gov/Press-Release/www/releases/archives/income_wealth/012528.html).

65. Nixon et al., *supra* note 1.

66. Cummins, *supra* note 49 (citing Minnesota Department of Commerce data analyzed by the Legal Services Advocacy Project).

67. *Id.* (analyzing census data and data from the Minnesota Department of Commerce and Reference USA).

68. *Id.*

*C. The Troublesome Features of Payday Loans**1. Triple-Digit Interest Rates*

In addition to exploiting low-income individuals and minority groups, payday loans come with additional features that trap unwary consumers. First, payday lenders charge inordinate fees that amount to annual percentage rates (“APR”) of 700%.<sup>69</sup> For example, when a consumer receives a \$100 loan and writes a check for \$115, the \$15 fee translates to an APR of 390%.<sup>70</sup> A Consumer Federation of America (“CFA”) survey of 230 payday lenders in 1999 found that lenders who made payday loans of \$100 to \$400 had interest rates of 390% to 871%.<sup>71</sup> Another CFA survey of 235 payday lenders in 2001 found that one-third of the lenders charged an APR greater than 500% for a fourteen-day loan of \$100.<sup>72</sup> In comparison, organized crime loan sharks in Las Vegas give better rates.<sup>73</sup> They typically charge 5% interest per week, or 260% APR.<sup>74</sup>

*2. The Debt Treadmill*

Another feature of payday loans traps consumers in a debt treadmill.<sup>75</sup> An especially dangerous feature of the payday loan is its rollover feature.<sup>76</sup> Industry officials claim that rollovers rarely occur, with “only a tiny number of transactions result[ing] in more than one rollover, of the perhaps 10% of transactions that result in any rollovers at all.”<sup>77</sup> Yet, audits conducted by various state agencies demonstrate that consumers renewed their loans on

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69. Elizabeth Renuart & Jean Ann Fox, *Payday Loans: A High Cost for a Small Loan in Low-Income and Working Communities*, 34 CLEARINGHOUSE REV. 589, 589 (2001) (citing data collected by the Colorado and Indiana credit code enforcement agencies).

70. Chin, *supra* note 51, at 728–29.

71. SHOW ME THE MONEY!, *supra* note 22, at 1.

72. FOX & MIERZWINSKI, *supra* note 58, at 5.

73. Chin, *supra* note 51, at 729.

74. *Id.*

75. Charles A. Bruch, Comment, *Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257, 1273–74 (2001) (comparing payday loans and the “debt treadmill” to pawnbroking, title pawns, and RTO agreements).

76. Chin, *supra* note 51, at 729.

77. Drysdale & Keest, *supra* note 18, at 606 n.91 (quoting testimony from Senator Joseph Lieberman’s Forum on Payday Lending that occurred on December 15, 1999).

average ten to twelve times during a twelve-month period.<sup>78</sup> A study conducted by the Center for Responsible Lending showed that payday lenders extend 91% of payday loans to consumers who take out five or more loans per year and that the average consumer received between eight and thirteen loans each year.<sup>79</sup> Additionally, many consumers use a second payday loan from another lender to pay off their first payday loan.<sup>80</sup>

In Minnesota, a sixty-one-year-old man, Reye DeLowell, turned to payday lenders for help even though he worked two jobs as a hotel custodian.<sup>81</sup> What was meant to be a short, temporary solution quickly turned into a long-term insoluble problem.<sup>82</sup> During a three-month period, DeLowell incurred more than \$200 in fees to essentially re-borrow the same \$250.<sup>83</sup> Thus, despite industry assertions to the contrary,<sup>84</sup> the payday lenders have every incentive to keep consumers in a perpetual cycle of debt, because a majority of payday lenders' revenue is generated from repeat transactions.<sup>85</sup>

### 3. Coercive Debt Collection Practices

Payday lenders frequently employ coercive techniques and intimidate consumers to collect debts.<sup>86</sup> Payday lenders threaten to pursue civil and criminal remedies under bad-check statutes and often collect treble damages and attorneys' fees in addition to regular bounced-check fees.<sup>87</sup> Despite efforts by states to exempt

78. KEEST & RENUART, *supra* note 43, § 7.5.5.4.

79. KEITH ERNST ET AL., CTR FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 5 tbl. 1, 7 (2004), <http://responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf>.

80. Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387, 411 (2005).

81. Nixon et al., *supra* note 1.

82. *Id.*

83. *Id.*

84. See CMTY. FIN. SERVS. ASS'N OF AM., BEST PRACTICES FOR THE PAYDAY ADVANCE INDUSTRY (2008), [http://www.moneytreeinc.com/documents/CFSA%20Best%20Practices\\_Feb08.pdf](http://www.moneytreeinc.com/documents/CFSA%20Best%20Practices_Feb08.pdf) [hereinafter BEST PRACTICES]. Community Financial Services of America, a payday lender lobbying organization, states that members of the organization shall not allow a consumer to rollover a loan except when expressly authorized by state law. *Id.* Even when states allow rollovers, members shall limit a consumer to four rollovers or the state prescribed annual limit, whichever is less. *Id.*

85. Chessin, *supra* note 80, at 411; Johnson, *supra* note 21, at 69–70.

86. Chin, *supra* note 51, at 732.

87. Bertics, *supra* note 42, at 140; Johnson, *supra* note 21, at 77–78.

payday-loan consumers from liability under bad-check statutes, payday lenders continue to use these statutes to collect on their loans.<sup>88</sup> For example, a nineteen-year-old woman in Alabama found herself in jail after she missed a payment on a \$200 payday loan.<sup>89</sup> The payday lender promised the nineteen-year-old a few more days to repay the loan but instead deposited her check; when it bounced, he sent a sheriff after her.<sup>90</sup>

The same coercive techniques occur in Minnesota. For example, one payday lender repeatedly contacted a consumer at work in a deliberate attempt to embarrass her.<sup>91</sup> The payday lender sent two faxes to the senior management office at the consumer's work place.<sup>92</sup> The faxes contained a photocopied image of the consumer's check that contained the letters "NSF NSF NSF NSF," which stands for "non-sufficient funds."<sup>93</sup> The fax also included a handwritten note that stated, in part, "[g]uess I put trust in the wrong people. Should I begin legal action, or can I trust you to begin payments?"<sup>94</sup> In violation of Minnesota law,<sup>95</sup> the payday lender also sent its own form—not the legally authorized form—to garnish the consumer's wages.<sup>96</sup>

### III. MINNESOTA STATE REGULATION OF PAYDAY LENDERS

#### A. *Minnesota Consumer Small Loan Statute*

Legal scholars place states' regulations of payday lenders into three groups.<sup>97</sup> The first consists of twelve states as well as the Virgin Islands and Puerto Rico, which have usury statutes that cap the interest rate at or around 36%, which effectively bans payday

88. MINN. STAT. § 609.535, subdiv. 5 (2008) (stating that penalties of the bad-check statute do not apply to postdated checks); Johnson, *supra* note 21, at 80–83 (discussing Ohio payday lenders who continue to collect treble damages for bad checks even though the Ohio legislature has barred the practice).

89. Dean Foust et al., *Easy Money: Subprime Lenders Make a Killing Catering to Poorer Americans*, BUS. WK., Apr. 24, 2000, at 107.

90. *Id.*

91. Complaint at 6, *Gorecki v. Kwik Cash*, No. 07CV02064, 2007 WL 2125572 (D. Minn. Apr. 26, 2007).

92. *Id.*

93. *Id.*

94. *Id.*

95. MINN. STAT. § 571.72, subdivs. 4, 5, & 7 (2008). These subdivisions outline the procedures and forms needed to garnish a person's wages. *Id.*

96. Complaint at 7, *Gorecki*, 2007 WL 2125572.

97. KEEST & RENUART, *supra* note 43, § 7.5.5.5.

lending.<sup>98</sup> The second group consists only of New Mexico and Wisconsin.<sup>99</sup> Lenders in these two states must comply with an ineffective small loan law.<sup>100</sup> The third category consists of thirty-six states along with the District of Columbia that have enacted laws or regulations specifically aimed at governing payday loan transactions.<sup>101</sup> Such regulations, at a minimum, require licensing of lenders, disclosures, and limits on the amount of the loan.<sup>102</sup> Minnesota fits into the third category.

The consumer small loan statute in Minnesota provides several substantive provisions that regulate payday lenders. First, the statute mandates licensing and disclosure requirements.<sup>103</sup> Second,

98. *Id.* The twelve states are Arkansas, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia. *Id.* at 297 n.479.

99. *Id.*

100. *Id.*

101. ALA. CODE §§ 5-18-1 to -18 (LexisNexis 1996 & Supp. 2008); ALASKA STAT. §§ 6.50.010-.900 (2008); ARIZ. REV. STAT. ANN. § 6-125 (2008); CAL. FIN. CODE §§ 23000-23106 (West 2008); COLO. REV. STAT. ANN. §§ 5-3.1-101 to -123 (West 2002 & Supp. 2008); DEL. CODE ANN. tit. 5, §§ 2227-2243 (2001 & Supp. 2006); D.C. CODE ANN. § 26-301 (LexisNexis 2005); FLA. STAT. ANN. § 560.401 (West 2002); HAW. REV. STAT. ANN. §§ 480F-1 to -7 (LexisNexis 2005 & Supp. 2008); IDAHO CODE ANN. §§ 28-46-401 to -413 (2005 & Supp. 2008); 815 ILL. COMP. STAT. ANN. 122/1-1 to 99/99 (West Supp. 2008); IND. CODE ANN. §§ 24-4.5-7-101 to -413 (West 2006 & Supp. 2008); IOWA CODE ANN. §§ 533D.1-.16 (West 2001 & Supp. 2008); KAN. STAT. ANN. § 16a-2-404 (2001); KY. REV. STAT. ANN. §§ 286.9-010-.990 (LexisNexis 2007 & Supp. 2008); LA. REV. STAT. ANN §§ 9:3578.1 to .8 (Supp. 2009); MICH. COMP. LAWS ANN. § 487.2121 (2008); MINN. STAT. § 47.60 (2008); MISS. CODE ANN. § 75-67-501 to -539 (2000 & Supp. 2007); MO. ANN. STAT. § 408.500 (West Supp. 2009); MONT. CODE ANN. §§ 31-1-701 to -728 (2008); NEB. REV. STAT. ANN. §§ 45-904 to -929 (LexisNexis 2005 & Supp. 2008); NEV. REV. STAT. ANN. §§ 604A.050 to .850 (LexisNexis Supp. 2007); N.H. REV. STAT. ANN. § 399-A:13 (LexisNexis 2005 & Supp. 2008); N.D. CENT. CODE §§ 13-08-01 to -15 (2004 & Supp. 2007); OHIO REV. CODE ANN. §§ 1315.35 to .99 (West 2004 & Supp. 2007); OKLA. STAT. ANN. tit. 59, §§ 3101-3119 (West Supp. 2009); OR. REV. STAT. ANN. §§ 725.600-.910 (West 2003 & Supp. 2008); R.I. GEN. LAWS §§ 19-14.4-1 to -10 (1998 & Supp. 2008); S.C. CODE ANN. §§ 34-39-110 to -260 (Supp. 2008); S.D. CODIFIED LAWS §§ 54-4-36 to -66 (2004 & Supp. 2008); TENN. CODE ANN. §§ 45-17-101 to -117 (2007 & Supp. 2008) and TENN. COMP. R. & REGS. 0180-28-.01 (2008); 7 TEX. ADMIN. CODE § 83.604(b) and TEX. FIN. CODE ANN. §§ 342.251-.259 (Vernon 2006 & Supp. 2008); UTAH CODE ANN. §§ 7-23-01 to -109 (2006 & Supp. 2008); VA. CODE ANN. §§ 6.1-444 to -471 (West Supp. 2008) and 10 VA. ADMIN. CODE § 5-200-10 (2008); WASH. REV. CODE ANN. § 31.45.010 (West 2008) and WASH. ADMIN. CODE § 208-630-120 (2008); WYO. STAT. ANN. §§ 40-14-362 to -364 (2007).

102. See NAT'L CONSUMER LAW CTR., 2005 SUMMARY OF STATE PAYDAY LOAN ACTS (Nov. 2005), [http://www.consumerlaw.org/issues/payday\\_loans/content/NCLC\\_SUMMARY.pdf](http://www.consumerlaw.org/issues/payday_loans/content/NCLC_SUMMARY.pdf).

103. MINN. STAT. § 47.60, subdvs. 3-4 (2008).

the statute allows, but does not require, a payday lender to offer a maximum term of thirty calendar days.<sup>104</sup> Third, the statute sets limits on finance charges and fees based on the amount of the loan.<sup>105</sup> Fourth, the statute caps payday loans at \$350.<sup>106</sup> Fifth, it forbids rollovers or concurrent loans in excess of \$350.<sup>107</sup> Sixth, failure to comply with the statute's requirements constitutes a misdemeanor.<sup>108</sup> Seventh, the law is enforced by investigating consumer complaints concerning payday lenders filed with the Commissioner of Commerce.<sup>109</sup>

### B. Weaknesses

While Minnesota's statute appears strong, it provides marginal protection for consumers in practice.<sup>110</sup> First, the statute fails to protect consumers from the debt treadmill. The statute prohibits rollovers but consumers can pay back one loan and immediately take out another.<sup>111</sup> Additionally, the statute has no mechanism in place to determine whether consumers have any other outstanding loans with other payday lenders.<sup>112</sup> Thus, consumers could easily avoid the statute's limits by obtaining additional payday loans from other lenders.

Another weakness concerns the statute's enforcement procedure, "which is based upon consumer complaints."<sup>113</sup> The

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104. *Id.*, subdiv. 2(b).

105. *Id.*, subdiv. 2(a).

106. *Id.*, subdiv. 1(a).

107. *Id.*, subdiv. 2(f). The loan statute states:

A loan made under this section must not be repaid by the proceeds of another loan under this section by the same lender or related interest. The proceeds from a loan made under this section must not be applied to another loan from the same lender or related interest. No loan to a single borrower made pursuant to this section shall be split or divided and no single borrower shall have outstanding more than one loan with the result of collecting a higher charge than permitted by this section or in an aggregate amount of principal exceed at any one time the maximum of \$350.

*Id.*

108. *Id.*, subdiv. 6.

109. *Id.*, subdiv. 5.

110. Noyes, *supra* note 47, at 1649 (citing Telephone Interview with Ron Elwood, Attorney, Legal Servs. Advocacy Project (Oct. 19, 2005)).

111. Nixon et al., *supra* note 1.

112. § 47.60, subdiv. 2(f) (requiring that borrowers only have one payday loan but failing to require a duty on lenders to determine whether consumers have other outstanding payday loans).

113. Noyes, *supra* note 47, at 1649.

Minnesota Department of Banking only audits lenders if a complaint has been filed and the Department admittedly receives “very few” complaints.<sup>114</sup> Consumers typically blame themselves for having incurred debt, fail to grasp that the law has been violated, and do not file complaints.<sup>115</sup>

The major flaw in the statute, however, lies in the ease with which many payday lenders are able to evade the statute and operate outside of it. Three of the four biggest payday lenders operate under Minnesota’s industrial loan and thrift statute.<sup>116</sup> These three lenders account for roughly 70% of the payday loans in Minnesota during 2006.<sup>117</sup> For example, a \$100 loan under the consumer small loan statute carries an APR of 391% as opposed to a \$100 loan under the thrift statute with an APR as high as 685%.<sup>118</sup> Additionally, the statute fails to address the coercive collection techniques that accompany payday loans. Thus, Minnesota’s small loan statute as drafted is ineffective.

#### IV. STRENGTHENING MINNESOTA’S CONSUMER SMALL LOAN STATUTE AND DEVELOPING WAYS TO PREVENT ABUSIVE, HIGH-RATE PAYDAY LENDERS

##### A. *Strengthening the Minnesota Statute*

Minnesota needs to amend the current statute to prevent the most harmful effects of payday loans. To accomplish this task, the Minnesota Legislature should incorporate various parts of the AARP Public Policy Institute’s Model Statute,<sup>119</sup> parts of other state laws, and parts of the Fair Debt Collection Practices Act.

First, the legislature should cap the interest rates on payday loans at 36% APR. Fifteen states have already done this, which

114. *Id.* (citing Telephone Interview with Ted Ellingson, Review Exam’r, Comm’n of Commerce, Minn. Dep’t of Banking (Feb. 27, 2006)).

115. *Senate Forum on Short-Term, High-Interest Paycheck Advances: Forum Before the S. Comm. on Governmental Affairs*, 106th Cong. (1999) (testimony of Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed’n of Am.) (“They think it’s their fault that they’re in debt over their heads and can’t get out, not that some law they never heard of has been violated. So I’m not surprised about the complaints.”).

116. Cummins, *supra* note 49.

117. *Id.*

118. *Id.*

119. ELIZABETH RENUART, AARP PUB. POL’Y INST., PAYDAY LOANS: A MODEL STATE STATUTE 1 (2000), [http://assets.aarp.org/rgcenter/consume/d16954\\_payday.pdf](http://assets.aarp.org/rgcenter/consume/d16954_payday.pdf).

helps eliminate triple-digit interest rates.<sup>120</sup> Federal legislation has also followed a similar approach. As payday lenders began to target military families, Congress enacted the Talent Amendment, which capped payday loan rates at 36% APR to members of the military and their families.<sup>121</sup>

Despite industry assertions, interest rate caps are necessary to correct a market failure in the payday loan industry.<sup>122</sup> While competition has increased between payday lenders, the market has failed to produce lower interest rates.<sup>123</sup> Studies show that interest rates have increased or remained the same despite the industry's growth.<sup>124</sup> In states with interest rate caps, a vast majority of the payday lenders continue to charge the highest legal interest rate permitted.<sup>125</sup> Moreover, payday lenders do not compete based on price but instead primarily on name recognition, speed, and promotions or specials.<sup>126</sup> Furthermore, payday lenders frequently refuse to disclose the interest rate and other loan terms until after the consumer applies for the loan, thereby preventing price shopping.<sup>127</sup> Thus, capping interest rates as opposed to relying upon market pressures will effectively prevent payday lenders from charging triple-digit interest rates.<sup>128</sup>

Additionally, society benefits as a whole from interest rate caps.<sup>129</sup> Interest rate caps may restrict the availability of credit for high-risk consumers and prevent some businesses from entering the industry.<sup>130</sup> Yet, creating entry barriers to discourage the unscrupulous lenders who focus on a comparatively narrow

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120. KEEST & RENUART, *supra* note 43, § 7.5.5.5.

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

122. Johnson, *supra* note 21, at 117–18; Bertics, *supra* note 42, at 142–45.

123. FOX & MIERZWINSKI, *supra* note 58, at 13–14.

124. *Id.* at 13.

125. *Id.* at 14; *see* Chessin, *supra* note 80, at 408–09 (noting that lenders operating under Colorado's payday loan statute mostly charge the statute's maximum allowable finance charge).

126. Bertics, *supra* note 42, at 143; 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, 1597–98 (2005).

127. Noyes, *supra* note 47, at 1662.

128. *Id.*

129. Drysdale & Keest, *supra* note 18, at 663–64.

130. *Id.*; *see generally* George J. Wallace, *The Uses of Usury: Low Rate Ceilings Reexamined*, 56 B.U.L. REV. 451 (1976) (discussing the advantages of, and providing ethical support for, low consumer-interest rate ceilings).



economic base would prevent “reverse redlining” and “discriminatory pricing.”<sup>131</sup> Additionally, unregulated interest rates prevent low-risk consumers from obtaining lower interest rates and causes high default rates for high-risk consumers.<sup>132</sup> Moreover, during periods of recession, households incur a rise in consumer debt and an increased exposure to high-rate payday loans, which in turn hurts other businesses.<sup>133</sup> This is so since the money spent by households indebted to high-rate payday loans “is not available for spending at the neighborhood grocery stores, service stations, pharmacies, or other local businesses.”<sup>134</sup> Payday lending consumers also constitute a growing share of bankruptcy petitioners.<sup>135</sup> Bankruptcies hurt other creditors.<sup>136</sup> Creating interest rate caps would mitigate the effects of high-rate debts.<sup>137</sup> Furthermore, states with interest rate caps at or around 36% for payday loans have saved their consumers \$1.5 billion while preserving a “more responsible small loan market.”<sup>138</sup>

Second, the legislature must require that payday lenders allow consumers to make installment loans at a minimum term of no less than two weeks for each \$50 owed on the loan.<sup>139</sup> A person earning \$35,000 a year has a difficult time paying back a typical payday loan while still meeting basic expenses during one two-week pay period.<sup>140</sup> After paying back the payday loan and basic expenses, a

131. Drysdale & Keest, *supra* note 18, at 663.

132. *Id.*

133. *Id.* at 663–64.

134. *Id.* at 664.

135. Robert Mayer, *Payday Lending and Personal Bankruptcy*, 50 CONSUMER INTERESTS ANN. 76, 81 (2004) (noting that in the collected sample, payday loan debtors increased in total numbers of personal bankruptcies, but did not “outstrip” the general growth in bankruptcies filed in the sample counties from 2000–2002) [hereinafter Mayer, *Payday Lending*]; see generally Robert Mayer, *One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County*, 5–6 (Loyola Univ. Working Paper 2005), available at <http://lwvmilwaukee.org/mayer21.pdf> (discussing bankruptcy petitioners who had pledged their entire next paycheck or more to payday lenders).

136. Mayer, *Payday Lending*, *supra* note 135, at 81 (noting that debt to benign creditors would not be written off due to bankruptcy filings likely caused by multiple payday loans).

137. Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 177–78 (1988).

138. URIAH KING & LESLIE PARRISH, CTR. FOR RESPONSIBLE LENDING, SPRINGING THE DEBT TRAP: RATE CAPS ARE ONLY PROVEN PAYDAY LENDING REFORM, EXECUTIVE SUMMARY 5 (2007), <http://www.responsiblelending.org/pdfs/springing-the-debt-trap-exec-summary.pdf>.

139. RENUART, *supra* note 119, at 17.

140. KING & PARRISH, *supra* note 138, at 4.

person earning \$35,000 annually is left with a \$112 deficit.<sup>141</sup> Thus, requiring payday lenders to allow consumers to make installment payments on their loans ensures a better chance of paying off the loan rather than defaulting.

Third, the legislature needs a more effective prohibition of rollovers. Although rollovers are currently prohibited, Minnesota's small loan statute does not have a cooling-off period.<sup>142</sup> A consumer can therefore close out the loan and reopen it, creating a back-to-back transaction, or essentially a rollover.<sup>143</sup> Additionally, Minnesota does not require a payday lender to inquire whether the consumer has any outstanding payday loans with any other payday lenders.<sup>144</sup> To prevent rollovers, Minnesota should prohibit payday lenders from issuing more than one payday loan to the same consumer for at least thirty days.<sup>145</sup> A thirty-day cooling-off period can prevent subterfuge, like back-to-back transactions.<sup>146</sup>

Minnesota should also mandate the creation of a real-time enforcement database similar to Florida's database to ensure that consumers do not receive more than one payday loan at a time. In Florida, the Department of Banking and Finance partnered with Veritec Solutions, a private company, to create a real-time database.<sup>147</sup> Payday lenders finance the database by paying up to one dollar per transaction.<sup>148</sup> A payday lender must check a

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141. *Id.* (citing expenditure data from the Bureau of Labor Statistics 2005 Consumer Expenditure Survey).

142. MINN. STAT. § 47.60, subdiv. 2(f) (2008).

143. Mark Flannery & Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?*, 4 n.10 (FDIC Ctr. for Fin. Research, Working Paper No. 2005-09, 2005), available at [http://www.chicagofed.org/cedric/files/2005\\_conf\\_paper\\_session1\\_flannery.pdf](http://www.chicagofed.org/cedric/files/2005_conf_paper_session1_flannery.pdf). A rollover requires only payment of additional fees, while a renewal requires repayment of the loan in full before a new loan is extended. *Id.* Generally, there is no distinction between these two types of transactions. *Id.*

144. See § 47.60, subdiv. 2(f) ("A loan made under this section must not be repaid by the proceeds of another loan made under this section by the same lender or related interest. The proceeds from a loan made under this section must not be applied to another loan from the same lender or related interest."). While providing this directive, the statute never requires the payday lender to check for other outstanding loans.

145. RENUART, *supra* note 119, at 22.

146. *Id.*

147. See FLA. STAT. ANN. § 560.404(23) (2002); Press Release, Veritec Solutions, LLC, The State of Florida Selects Veritec Solutions to Develop and Manage the Deferred Presentment Customer Eligibility Verification and Transaction Authorization System (Dec. 5, 2001), [http://www.veritecs.com/selectveritec12\\_05\\_01.htm](http://www.veritecs.com/selectveritec12_05_01.htm).

148. See FLA. STAT. ANN. § 560.404(23) (2002); FLA. DEP'T OF BANKING & FIN., DEFERRED PRESENTMENT PROGRAM, 2002 ANNUAL PROGRAM REPORT TO THE

consumer's loan eligibility by entering the consumer's information into a centralized database.<sup>149</sup> If the consumer fails to satisfy the statutory restrictions, the transaction cannot be completed.<sup>150</sup> Florida's database compiles data that allows regulatory agencies to monitor payday loan activities throughout the state.<sup>151</sup> Thus, Florida's database effectively prevents a consumer from being issued more than one payday loan at a time and provides regulators with valuable information about the payday loan industry.<sup>152</sup>

Fourth, Minnesota should require payday lenders to determine a consumer's ability to repay loans and restrict the amount that consumers can borrow based upon their income.<sup>153</sup> Indiana's payday loan statute prohibits lenders from lending more than 20% of a consumer's gross income.<sup>154</sup> Limiting the amount consumers borrow based on their income prevents them from pledging their next paycheck, or more to payday lenders, and decreases the probability of default.<sup>155</sup> This would burden payday lenders with more responsibilities.<sup>156</sup> However, requiring payday lenders to determine a consumer's ability to pay back the loan "prevent[s] consumers from becoming further overwhelmed by debt."<sup>157</sup>

Fifth, Minnesota must prohibit abusive debt collection practices by payday lenders.<sup>158</sup> The Community Financial Services Association of America ("CFSAA"), a lobbying group for payday lenders, currently encourages members to "collect past due accounts in a professional, fair and lawful manner."<sup>159</sup> The CFSAA also encourages members not to use unlawful threats, intimidation, or harassment and to use the Fair Debt Collection Practices Act

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LEGISLATURE 4 (2003), <http://www.veritecs.com/Annualreport.pdf> [hereinafter DEFERRED PRESENTMENT PROGRAM].

149. See Veritec Solutions, LLC, Applying Business Intelligence to Payday Lending Regulatory Solutions, <http://www.veritecs.com/PaydaySolution.htm> (last visited Mar. 20, 2009).

150. *Id.*

151. *Id.*

152. See DEFERRED PRESENTMENT PROGRAM, *supra* note 148, at 4.

153. Noyes, *supra* note 47, at 1665 (recommending that Wisconsin adopt this approach).

154. IND. CODE ANN. § 24-4.5-7-402(1) (Supp. 2008).

155. Noyes, *supra* note 47, at 1665.

156. See Johnson, *supra* note 21, at 140 (advocating this approach, which is already used by mortgage lenders, for enactment at the federal level).

157. Noyes, *supra* note 47, at 1665.

158. See *supra* Part II.C.3.

159. BEST PRACTICES, *supra* note 84.

(“FDCPA”)<sup>160</sup> as a guide when collecting on past due accounts.<sup>161</sup>

The FDCPA prohibits “any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of a debt.”<sup>162</sup> This includes the threat of or use of violence, obscene or profane language, or engaging a person in a telephone conversation repeatedly or continuously when attempting to collect a debt.<sup>163</sup> The FDCPA also prohibits “any false, deceptive, or misleading representation in connection with the collection of any debt.”<sup>164</sup> This section of the FDCPA includes an extensive list of prohibited conduct.<sup>165</sup> For example, it prohibits the “false representation of the character, amount, or legal status of any debt,”<sup>166</sup> threats to take action that cannot be legally taken,<sup>167</sup> or the “use of any false representation or deceptive means to collect or attempt to collect any debt.”<sup>168</sup> The FDCPA only applies to third-party debt collectors<sup>169</sup> and cannot impose liability against payday lenders who collect their own delinquent accounts.<sup>170</sup> The Minnesota Legislature should incorporate the CFSAA recommendations and the above-referenced FDCPA provisions to bring to a halt the abusive and coercive methods used by payday lenders who collect overdue accounts.<sup>171</sup>

Sixth, the Minnesota Legislature must create an effective enforcement mechanism. Minnesota legislators should create a private right of action that allows for actual, consequential, and punitive damages,<sup>172</sup> plus statutory damages up to \$1,000 and

160. 15 U.S.C. § 1692 (2006).

161. BEST PRACTICES, *supra* note 84.

162. 15 U.S.C. § 1692d (2006).

163. *Id.* § 1692d(1)–(2), (5).

164. *Id.* § 1692e.

165. *Id.*

166. *Id.* § 1692e(2)(A).

167. *Id.* § 1692e(5).

168. *Id.* § 1692e(10).

169. *Id.* § 1692a(6).

170. Johnson, *supra* note 21, at 81 (stating that payday lenders ordinarily collect their own debt and are therefore not considered “debt collectors” under the FDCPA definition); *see* § 1692a(6)(A) (excluding from liability under the FDCPA any officer or employee of a creditor who collects debt in the name of the creditor for the creditor).

171. *See* Johnson, *supra* note 21, at 77–78 (discussing the inappropriate collection practices of some payday lenders); *supra* Part II.C.3; *see also* Johnson, *supra* note 21, at 92–93 (discussing how even though Ohio law does not permit prosecution of payday loan consumers under its bad-check statute, criminal prosecutions still occur).

172. RENUART, *supra* note 119, at 23.

reasonable attorneys' fees.<sup>173</sup> Currently, Minnesota allows a consumer to recover up to \$100 for each violation of the consumer small loan statute.<sup>174</sup> However, Minnesota does not allow for the recovery for actual, consequential, or punitive damages; nor does it allow for recovery of attorneys' fees.<sup>175</sup> Additionally, Minnesota's enforcement mechanism for violations relies on consumer complaints with the Commissioner of Commerce.<sup>176</sup> Even if consumers filed complaints, enforcement through the Commissioner of Commerce may be inadequate given the growth of the payday lending industry, and because agencies frequently lack sufficient resources to investigate problems and undertake enforcement actions.<sup>177</sup> Thus, creating a private right of action can help assist consumers who have been injured by a violation.<sup>178</sup> Furthermore, a strong enforcement mechanism is essential to enforcing these substantive regulations.<sup>179</sup>

Finally, Minnesota must require that all payday lenders operate under the consumer small loan statute. As of February 2009, only fifty-eight payday lending locations held licenses under Minnesota's small loan law.<sup>180</sup> Three of the four largest payday lenders in Minnesota operate under the industrial loan and thrift statute, which allows for higher fees.<sup>181</sup> Thus, it is necessary to close this loophole to make Minnesota's consumer small loan statute effective.

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173. The FDCPA allows for the recovery of statutory damages up to \$1,000 and for the recovery of reasonable attorneys' fees. 15 U.S.C. § 1692k(a)(2)(A), (3) (2006).

174. MINN. STAT. § 56.19, subdiv. 2a (2008) (allowing up to \$100 in damages for each violation against any lender who intentionally violates the consumer small loan statute). *See also* MINN. STAT. § 47.60, subdiv. 6 (2008) (imposing liability upon others who violate or participate in the violation of any provision of the consumer small loan statute in the same manner as in section 56.19).

175. *See* § 56.19, subdiv. 4 (stating that the remedies in section 56.19 are exclusive).

176. § 47.60, subdiv. 5.

177. RENUART, *supra* note 119, at 23.

178. *Id.*

179. *See* Noyes, *supra* note 47, at 1665–66 (advocating for strong enforcement mechanisms for effective legislation).

180. Minn. Dep't of Commerce, Small Lender Licensee List, <http://www.commerce.state.mn.us/FSLicensees/sl.html> (last visited Mar. 20, 2009).

181. Cummins, *supra* note 49. *See* Minn. Dep't of Commerce, Industrial Loan List, <http://www.commerce.state.mn.us/FSLicensees/il.html> (last visited Mar. 20, 2009).

An effective statute requires the Minnesota Legislature to enact specific usury limits, prohibit rollovers and concurrent loans, and assess a consumer's ability to repay the loan. Additionally, an effective statute must specifically address collection efforts, provide an enforcement mechanism for consumers, and require payday lenders to operate under the statute.

*B. Litigation*

Legislation can prevent some of the harmful effects on payday lending. It alone, however, will not suffice.<sup>182</sup> Payday lenders continuously repackage their products attempting to disguise the loans as something other than a payday loan.<sup>183</sup> To help combat such evasive maneuvers and limit the effects of payday lenders, consumer advocates can utilize current legislation to bring lawsuits against payday lenders.

The Truth in Lending Act ("TILA"),<sup>184</sup> the main federal regulation that governs payday lenders,<sup>185</sup> provides a useful tool for combating payday lenders in the courtroom. Congress enacted TILA in 1968 to increase consumers' awareness of the cost of credit.<sup>186</sup> The purpose was to "assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit."<sup>187</sup>

Payday lenders are bound by TILA's disclosure requirements because they are creditors that regularly issue consumer credit.<sup>188</sup> Despite the plain language, payday lenders originally claimed to be

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182. Noyes, *supra* note 47, at 1666.

183. Erick Bergquist, *Credit Line Is Key in Pa. Payday Twist*, AM. BANKER, June 23, 2006, at 1. Advance America was no longer able to make payday loans in Pennsylvania, so the company started offering open-credit lines for up to \$500 that charged a monthly participation fee of \$149.95, plus principal and interest payments. *Id.*

184. 15 U.S.C. §§ 1601–67 (2006).

185. Johnson, *supra* note 21, at 13. The Racketeering Influenced and Corrupt Organizations Act (RICO) also governs payday lenders. 18 U.S.C. §§ 1961–68 (2006). Passed by Congress in 1970, RICO is the other key federal law that affects the payday lending industry. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, 923 (codified as amended at 18 U.S.C. §§ 1961–68 (2006)). RICO prohibits lenders from providing credit at a usurious rate, or twice the legal interest rate. *Id.* § 1961(6). RICO allows the government to bring criminal charges against payday lenders for RICO violations. *Id.* § 1963.

186. Johnson, *supra* note 21, at 13–14.

187. 15 U.S.C. § 1601(a) (2006).

188. Johnson, *supra* note 21, at 14.

exempt from TILA requirements.<sup>189</sup> Payday lenders argued that they provide a service for a set fee and were therefore not required to comply with TILA.<sup>190</sup> The courts<sup>191</sup> and the Federal Reserve Board,<sup>192</sup> however, ruled that payday loans are consumer credit.

TILA's remedial measures compensate consumers in the form of statutory and actual damages for violations of TILA's disclosure requirements.<sup>193</sup> Once a disclosure violation is established under TILA, statutory damages are automatically available regardless as to whether an actual injury has occurred.<sup>194</sup> Statutory damages are twice the amount of any finance charge in the particular transaction.<sup>195</sup> Conversely, actual damages are only available for actual compensatory injuries incurred by the violation.<sup>196</sup>

TILA's disclosure requirements are meticulously specific.<sup>197</sup> Violations occur for using the wrong typeface for a financing term,<sup>198</sup> or for failing to provide documents at the proper time during the loan transaction.<sup>199</sup> TILA also allows for class action lawsuits.<sup>200</sup> Thus, the ease for which TILA can be violated provides consumers with an important tool against payday lenders who run afoul of the disclosure requirements.<sup>201</sup>

189. *Id.* at 16. Payday lenders originally claimed they were not bound by TILA because they were check-cashing services. *Id.* See generally Deborah A. Schmedemann, *Time and Money: One State's Regulation of Check-Based Loans*, 27 WM. MITCHELL L. REV. 973, 976 (2000) (discussing the difference between check-cashing services and payday loans).

190. Bruch, *supra* note 75, at 1274–75.

191. See, e.g., *Cashback Catalog Sales, Inc. v. Price*, 102 F. Supp. 2d 1375, 1382 (S.D. Ga. 2000); *Turner v. E-Z Check Cashing of Cookeville, Tenn., Inc.*, 35 F. Supp. 2d 1042, 1048 (M.D. Tenn. 1999).

192. Johnson, *supra* note 21, at 38.

193. 15 U.S.C. § 1640(a)(1)–(2) (2006).

194. *Id.* § 1640(a)(2)(A).

195. *Id.* § 1640(a)(2)(A)(i).

196. *Id.* § 1640(a)(1). It is more difficult to prove actual injury and receive damages compared to statutory damages under a violation of TILA's disclosure requirements. See Eugene J. Kelley, Jr. & John L. Ropiequet, *Actual Damages Under the TILA: Collapsing Class Actions*, 55 CONSUMER FIN. L.Q. REP. 200, 200 (2001).

197. Thomas A. Wilson, *The Availability of Statutory Damages Under TILA to Remedy the Sharp Practice of Payday Lenders*, 7 N. C. BANKING INST. 339, 344 (2003).

198. *Brown v. Payday Check Advance, Inc.*, 202 F.3d 987, 990 (7th Cir. 2000).

199. *Kilbourn v. Candy Ford-Mercury, Inc.*, 209 F.R.D. 121, 124–25 (W.D. Mich. 2002).

200. § 1640(a)(2)(B).

201. *Payday Check Advance, Inc.*, 202 F.3d at 989–90; see Ann Hayes Peterson, *Payday Loans*, CREDIT UNION MAG., Dec. 2000, at 57 (noting how payday lenders do not follow TILA because they believe it does not apply to their business practices); see, e.g., *Kilbourn*, 209 F.R.D. at 124–25 (regarding a class action against a financier

Yet, TILA does have its shortcomings. The court in *Brown v. Payday Check Advance, Inc.* limited statutory damages for only violations of the paragraphs enumerated by section 1640(a)(4).<sup>202</sup> The court held that statutory damages are available “only for failing to comply with the requirements of section 1635 of [TILA] or of paragraph (2) (insofar as it requires a disclosure of the ‘amount financed’), (3), (4), (5), (6), or (9) of section 1638(a) of [TILA].”<sup>203</sup> The Eighth Circuit has reached the same conclusion.<sup>204</sup> Statutory damages are automatic, as opposed to actual damages, which are harder to prove.<sup>205</sup> Nonetheless, a consumer can use TILA to his advantage.

For example, in *Van Jackson v. Check ‘N Go of Illinois, Inc.*, the plaintiffs successfully litigated a class action lawsuit against a payday lender because the lender failed to disclose the check as a security interest.<sup>206</sup> A postdated check, which payday lenders frequently use to secure the payday loan, is required to be disclosed as a security interest.<sup>207</sup> TILA requires a lender, when credit is secured, to provide a statement that a security interest had been taken in property not purchased as part of the credit transaction.<sup>208</sup>

In *Van Jackson*, the defendant’s disclosure regarding the check as a security interest was not grouped together with the other required disclosures.<sup>209</sup> Instead the disclosure was placed on the back of the consumer loan agreement in small type under a heading entitled “Method of Payment.”<sup>210</sup> The court held that the

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of automobiles).

202. 202 F.3d at 989. *Payday Check Advance* is the first case concerning payday loans and statutory damages under TILA.

203. *Id.* at 991 (emphasis added).

204. *See e.g.*, *Malchow v. GMI Acquisitions, Inc.*, Civ. No. 01-1662, 2002 WL 31185865, at \*3–5 (D. Minn. Oct. 1, 2002); *Peter v. Village Imports Co.*, Civ. No. 01-12, 2001 WL 1640130, at \*3 (D. Minn. Oct. 9, 2001); *Wojcik v. Courtesy Auto Sales, Inc.*, No. 8:01CV506, 2002 WL 31663298, at \*5 (D. Neb. Nov. 25, 2002).

205. *Kelley & Ropiequet, supra* note 196, at 200.

206. 123 F. Supp. 2d 1079, 1080–81 (N.D. Ill. 2000) (granting plaintiff’s motion for summary judgment and awarding statutory damages).

207. *Id.* at 1083 (holding that a check is a security interest under 15 U.S.C. section 1638(a)(9)). *See Smith v. Cash Store Mgmt., Inc.*, 195 F.3d 325, 331 (7th Cir. 1999) (holding that a check is a security for a loan).

208. 15 U.S.C. § 1638(a)(9) (2006). *See also* 12 C.F.R. § 226.18(m) (2008) (stating that a security interest must be disclosed in other property and identified by item or type).

209. All disclosures required by federal law must be grouped together and conspicuously segregated from other information. § 1638(b)(1).

210. *Van Jackson v. Check ‘N Go of Illinois, Inc.*, 193 F.R.D. 544, 548 (N.D. Ill. 2000). The disclosure read as follows:



defendant failed to comply with section 1638(a)(9) because the security interest disclosure was not accessible to an average person and was hidden among other material in fine print underneath the “Method of Payment” heading.<sup>211</sup> Thus, if a consumer can establish that a payday lender did not make the disclosures enumerated under section 1638(a)(9) accessible to an average person, that consumer can be awarded statutory damages pursuant to section 1640(a)(4).<sup>212</sup>

### C. Market Pressure

An increase in the number of payday lenders has failed to decrease the costs of payday loans.<sup>213</sup> Increased competition from banks and credit unions in the payday loan market, however, could decrease prices and create more options for consumers.<sup>214</sup> A 2005 study found that banks and credit unions could provide lower-cost, small-dollar credit products compared to payday lenders.<sup>215</sup> Banks and credit unions can provide lower-cost alternatives because they have a preexisting infrastructure that helps minimize operational costs.<sup>216</sup> Banks and credit unions already have the facilities, loan staff, and collection processes in place.<sup>217</sup> Banks and credit unions also have an established consumer base, which minimizes

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You may prepay this contract in full at any time. In accordance with the Truth in Lending Act (15 U.S.C. Section 1615) and the Illinois Consumer Installment Loan Act (205 ILCS 670/15), if you pay off this loan you shall be entitled to a refund of the unearned portion of the Finance Charge, unless that refund would be less than \$1.00. The refund will be calculated in accordance with the method required by the Truth in Lending Act (15 U.S.C. Section 1615) and by the Illinois Consumer Installment Loan Act (205 ILCS 670/15). Upon determination of the amount owed based on your prepayment of the loan, we will return your check, which was used as security for the loan, and request from you of the amount due as revised in accordance with you prepayment.

*Id.*

211. *Id.*

212. *See* U.S. v. Bank of Farmington, 166 F.3d 853, 860 (7th Cir. 1999). The meaning of “disclosure” is “opening up to view, revelation, discovery, exposure.” *Id.* (citing 4 OXFORD ENGLISH DICTIONARY 738 (2d ed. 1989)); *see also* Basham v. Fin. Am. Corp., 583 F.2d 918, 926 (7th Cir. 1978) (stating that disclosures must follow a logical order and not be scattered throughout an agreement).

213. *See supra* notes 122–28 and accompanying text.

214. Bertics, *supra* note 42, at 149–50 (arguing that banks should compete with payday lenders).

215. BAIR, *supra* note 30, at 28–29.

216. *Id.* at 28.

217. *Id.*

marketing costs.<sup>218</sup> Banks and credit unions can market small-loan products through preexisting channels, such as inserts in account statements.<sup>219</sup> Conversely, payday lenders must set up stores, recruit staff, and use mass media to advertise.<sup>220</sup>

Banks and credit unions can also provide lower-cost alternatives because they can minimize losses by using direct deposit and automatic deductions for repayment.<sup>221</sup> When a payday lender cashes a consumer's postdated check, the lender's check waits in line behind other withdrawals that occurred before the payday lender attempted to cash the consumer's postdated check.<sup>222</sup> Unlike payday lenders, banks and credit unions can make a priority claim on checking account funds to ensure their loan is paid.<sup>223</sup> Additionally, banks and credit unions derive their income from a variety of products and services. Banks and credit unions are therefore in an overall better position to provide small loans at a lower cost than payday lenders.<sup>224</sup>

Nevertheless, banks and credit unions have traditionally shied away from offering payday loans.<sup>225</sup> Bank officials consider payday loans to be high-risk products that require extremely high interest rates to maintain profitability.<sup>226</sup> Such loans would tarnish the bank and credit union's image in the community.<sup>227</sup> Banks are also reluctant to enter the payday loan market due to a perceived regulatory animosity toward partnerships involving federally regulated banks and payday lenders.<sup>228</sup> However, this perception appears to be misguided.<sup>229</sup> Informally, bank regulators have "agreed that banks and credit unions should be encouraged to develop low-cost small dollar credit products" for consumers.<sup>230</sup> Furthermore, developing low-cost payday loans can help banks and credit unions earn credit under the Community Reinvestment Act, which requires financial institutions to meet their communities'

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218. *Id.*  
219. *Id.*  
220. *Id.*  
221. *Id.*  
222. *Id.*  
223. *Id.*  
224. *Id.*  
225. *Id.* at 10.  
226. *Id.*  
227. *Id.*  
228. *Id.*  
229. *Id.*  
230. *Id.*

credit needs.<sup>231</sup>

Moreover, credit unions have developed successful and profitable payday loan programs.<sup>232</sup> In 2001, the North Carolina State Employees' Credit Union ("NCSECU") began offering a revolving loan with a maximum balance of \$500 and an APR of 12%.<sup>233</sup> The loan must be repaid in full on the consumer's next payday by automatic deduction.<sup>234</sup> The charge for a \$500, two-week loan is less than \$2.50.<sup>235</sup> An applicant must have direct deposit into their credit union account to qualify.<sup>236</sup> An important feature of the account is that it requires the consumer to put 5% of each advance in a savings account.<sup>237</sup> Access to the product is unlimited, but if the consumer withdraws the savings, he cannot access the product for six months.<sup>238</sup>

The program has made a total of \$305,405,278 in loans and has generated \$1,919,097 in interest income. Roughly 40,000 members use the product and about 70% use the product once a month. Recurrent use, from a public policy standpoint, is less problematic if the rate charged is comparable or less than a credit card.<sup>239</sup> Additionally, NCSECU officials hope that over time, the mandatory savings will decrease the consumer's reliance on the product.<sup>240</sup> In less than eighteen months, the savings component has resulted in more than \$6 million in new deposits for NCSECU.<sup>241</sup>

A New Orleans credit union has also developed a successful model.<sup>242</sup> ASI Federal Credit Union, a \$200 million asset low-income community development credit union located in an economically distressed area of New Orleans, began offering \$500 lines of credit at a 12% interest rate in 2002 along with other

231. *Id.*; see 12 U.S.C. § 2901(a) (2000). Higher favorable ratings under the Community Reinvestment Act lead to fewer evaluations. See Chin, *supra* note 51, at 750.

232. BAIR, *supra* note 30, at 21–22.

233. *Id.*

234. *Id.*

235. *Id.*

236. *Id.*

237. *Id.*

238. *Id.*

239. *Id.*

240. *Id.* at 22.

241. *Id.*

242. *Id.* at 23.

financial services.<sup>243</sup> The line of credit has a flat fee of \$4 a week.<sup>244</sup> With nearly 8,000 lines of credit issued in 2004, the product has been popular and profitable.<sup>245</sup> In 2003, the line of credit generated \$947,000 in fees and \$1,046,000 in 2004.<sup>246</sup>

Providing small-loan alternatives can also help consumers build a credit history so that they may qualify for larger, more profitable loans in the future.<sup>247</sup> Banks and credit unions could therefore remain profitable *and* compete with payday lenders; offering lower prices could decrease the demand for high-cost payday loans and force payday lenders to decide between offering better terms or going out of business.<sup>248</sup>

## V. CONCLUSION

The payday loan industry is one more manifestation of various short-term lending schemes that have plagued this country throughout the past century by exploiting desperate, cash-strapped consumers.<sup>249</sup> This exploitation of low-income consumers not only harms the consumer, it also places a needless drag on the economy.<sup>250</sup> The current lending crisis, which began in 2007 and has led to the collapse of several major American financial institutions, illustrates the need to curb abusive lending practices.<sup>251</sup> As credit tightens and our economy suffers in the current recession, more consumers will continue to turn to payday loans. The prevention of abusive lending practices and the promotion of responsible lending not only benefits the economy but also the impacted communities. The recommendations in this article can both prevent abusive payday lending practices in Minnesota and serve as a guide for other states. Low-income consumers who live

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243. *Id.* at 23–24. ASI Federal Credit Union’s financial package also includes a ten-minute phone card, free travelers checks, a free refund anticipation loan, and twenty-five-cent money orders. *Id.* at 23.

244. *Id.* at 23.

245. *Id.* at 24.

246. *Id.*

247. *Id.* at 26.

248. *See Bertics, supra* note 42, at 149–50 (discussing banks’ and credit unions’ ability to offer payday loans and force payday lenders to offer lower prices).

249. Bruch, *supra* note 75, at 1287.

250. CONSUMERS UNION, THE NAT’L CONSUMER LAW CTR., CONSUMER FED’N OF AM., SMALL DOLLAR LOAN PRODUCTS, INTRODUCTION TO THE SCORECARD 3 (2008), [http://www.consumerfed.org/pdfs/small\\_loan\\_scorecard\\_08.pdf](http://www.consumerfed.org/pdfs/small_loan_scorecard_08.pdf).

251. *See id.* at 4 (discussing how stronger consumer protection guidelines could have prevented the subprime mortgage lending crisis).

2009]

PAYDAY LENDING ABUSE

1161

paycheck to paycheck will at times have to rely on payday loans to help manage unexpected expenses. However, payday loans do not have to become a noose around the neck of such consumers.