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

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Abstract

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

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I. INTRODUCTION

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

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

2 Ballot measures on usury limits have occurred in Arizona, Montana, and Ohio. The public voted overwhelmingly in favor of usury limits in all three states. Marian McClure, Let’s Make Sure the Sun Sets on Arizona Payday Loans, Arizona Republic, November 21, 2009, B5 (“60 percent of Arizona voters soundly rejected 400 percent annual interest rates on payday loans, when 1.2 million Arizonans rejected the payday lenders' Proposition 200. The lenders spent more than $14
polarized politics, usurious lenders have lost these ballot measures in red, blue, and swing states. These votes against predatory credit pricing are even more emphatic when considered in light of massive industry advertising campaigns that nonetheless utterly failed to persuade voters.

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. Every signatory to the Declaration of Independence returned to Colonies that aggressively capped interest rates. When the “greatest generation” assumed the mantle of public leadership after emerging from the Great Depression and the Second World War, all fifty states capped interest rates on small consumer loans with median limit of 36% per annum. For generations, the Federal Bureau of Investigation used undercover investigations to track down usurious lenders and incarcerate them. 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. While not all subscribe to this moral value, it is million trying to fool the people. The voters saw through their scam.”); Editorial, Great Falls Tribune (Great Falls, MT), January 6, 2011, (“Ballot Initiative 164, which took effect Jan. 1, capped the annual interest rates on payday and car title loans at 36 percent. The measure passed with 72 percent of the vote statewide. It won in every county and House district . . . .”); Editorial, Ohio Voters Prove that a Good Idea Can Beat $22 Million, Akron Beacon Journal, November 6, 2008 (“Voters handed the industry a deservedly humiliating defeat, rejecting one of the slickest and most misleading campaigns in the state this election season by a ratio of roughly 2-to-1. The defeat of the lenders is particularly gratifying, as their efforts carefully concealed the industry’s goal to regain the license to charge excessive interest rates to borrowers desperate for quick loans.”).

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

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

5 See infra note X and accompanying text.

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


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

Nevertheless, in recent decades federal and state usury law has become more lax and less transparent. The Supreme Court’s decision in *Marquette Nat’l Bank v. First Omaha Serv. Corp.* 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. This ignited a race to the bottom where state legislatures were pressured to raise or eliminate usury limits in order to avoid “discriminating” against local banks. Moreover, high inflation in the late 1970s raised lenders’ cost of funds, making profitable consumer lending temporarily more difficult within traditional interest rate caps. This unusual macroeconomic pressure led some states to relax or eliminate their usury limits. 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 usurious lending to families. Responding to the vacuum in usury law, over a hundred different local governments

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“If thou lend money to any of my people that is poor by thee, thou shalt not be to him as an usurer, neither shall thou lay upon him usury.” Exodus 22:25 (King James). See also Ezekiel, 18:8-17; Ezekiel 22:16-22; Jeremiah, 15:10; John 2:14-15; Leviticus, 25:35-37; Luke 6:33-35; Mathew 5:42; Neh. 5:1-13; Proverbs 28:6-9; Psalm 15:1, 4-5. The Biblical condemnation of usurious lenders is closely related to the deep and consistent message of the Bible demanding kind and just treatment of poor and vulnerable members of society. Deuteronomy demands “thou shalt not oppress an hired servant that is poor and needy, whether he be of thy brethren, or of thy strangers that are in thy land within thy gates.” Deut., 24:14. The Bible commands Christians to “[e]xecute true judgment, and shew mercy and compassion every man to his brother; and oppress not the widow, nor the fatherless, the stranger, nor the poor….“ Zechariah 7:9-10. *See also* Steven Graves M. Graves and Christopher L. Peterson, *Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation*, 57 CATH. L. REV. 636, 648-654 (2008) (summarizing post-reformation Christian theology of usury law);

10 *439 U.S. 299 (1978).*

11 *Error! Main Document Only.*

12 *Paul R. Beares, Consumer Lending 12* (2d ed. 1992)

13 *Id.*
around the country have adopted ordinances attempting to restrict payday and car title lending.\textsuperscript{14} Although this growing trend has generated relatively little national press or scholarly commentary,\textsuperscript{15} it appears to reflect the great majority of the American public that supports the illegality of triple-digit interest rate loans and the long historical tradition of treating payday and car title lending as a serious civil offense, and in many states, a crime.

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

\section*{II. THE LAW OF PREDATORY SMALL LOANS IN HISTORICAL CONTEXT}

All of the thirteen original American states aggressively regulated consumer loans with annual interest rate caps of between eight and five percent, with six percent being most typical.\textsuperscript{16} 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.\textsuperscript{17} Both American and English usury law grew out of both Protestant and Catholic theology on

\textsuperscript{14} Unpublished database on file with author.


\textsuperscript{16} Tyler, \textit{supra} note X, at 50-3; Peterson, Salience Distortion, \textit{supra} note X, at 1117-18.

\textsuperscript{17} Act to Reduce the Rate of Interest, 1713, 12 Ann., c. 16 (Eng.).
the moral limits of acceptable lending practices. 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. 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. 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. State Small Loan Acts licensed finance companies authorizing them to charge interest rates ranging from 18 to 42 percent per year, with 36% being typical. Social reformers that lobbied for these rules argued that ordinary citizens ought to have access to credit, and that higher interest rate limits in this range were still within a price zone where borrowers could benefit from the credit and have a reasonable opportunity to repay. These low double-digit interest rate usury limits allowed the development of credit cards and retail installment loan

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

19. See infra notes X-X and accompanying text.


21. Id.


23. Peterson, Salience Distortion, supra note X, at X.

purchasing that became a staple of middle class America. In the 1960s, for example, every state in the union had some form of a small loan law on the books. 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. From America’s emergence as an industrial power at the turn of the twentieth century through the apogee of our hegemonic leader, the premier bastion of consumer protection law were state Small Loan Acts championed by the Russell Sage Foundation.

The United States Supreme court was the first government institution to meaningfully disrupt the centuries old tradition of American usury law. In the 1978 case of *Marquette National Bank v. First of Omaha Service Corp.*, 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? Turning to National Bank Act, a statute adopted in 1864, the Supreme Court concluded that Congress had

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26 Peterson, *Salience Distortion*, supra note X, at X; Homer & Sylla, supra note X, at X. See, e.g., Com. v. Morris, 176 Mass. 19, 56 N.E. 896 (1900) (holding Massachusetts’ criminal penalties of sixty days incarceration for violation of 12 percent simple nominal annual usury limit was constitutional); Ex parte Berger, 193 Mo. 16, 90 S.W. 759 (1905) (holding Missouri criminal penalties of 30 to 90 days incarceration for violation of 12 percent annual interest rate limit was constitutional); Jarvis v. State, 69 Ga. App. 326, 25 S.E.2d 100, 101 (1943) (upholding criminal conviction of for making an approximately 312% annual interest rate salary loan in violation of Georgia’s small loan usury limit); Beasley v. Coleman, 136 Fla. 393, 180 So. 625 (1938) (quashing habeas corpus petition that challenged conviction for making an approximately 520% interest rate salary loan in violation of Florida’s statute imposing up to six months incarceration for usury); People v. Lombardo, 61 N.Y.2d 97, 472 N.Y.S.2d 589, 460 N.E.2d 1074 (1984) (holding New York statute defining lending in excess of 25% annual interest as a class C felony was not unconstitutionally vague). Some states temporarily experimented with eliminating their usury laws for short periods in the 19th century. George Holmes, *Usury Law in Practice and in Psychology*, 7 Pol’y Sci. Q. 431, 432 (1892). Moreover, in the “wild west” it would often take a few years before newly formed states and territories would adopt usury limits. *Id.* at 436-442.
28 *Id.* at 309–13.
intended the law of the bank’s home state to apply. While seemingly innocuous, this holding gave a handful of rural states the opportunity to deregulate every other state’s usury limits with respect to federally chartered banks. Recognizing the opportunity to attract banking jobs to their moribund economies, 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.

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. While Congress did not explicitly authorize the “exporting” model of deregulation, it did finesse the issue by granting state banks whatever power already held by national banks. 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. Seeing no point in punishing their local financial institutions, virtually every other state in the

30. *Marquette Nat’l Bank*, 439 U.S. at 309–13; see also *Nat’l Consumer Law Ctr.*, supra note Error! Bookmark not defined., at § 3.4.5.1.1 (questioning the historical accuracy of *Marquette*); *Bray Hammond, Banks and Politics in America from the Revolution to the Civil War* 725–34 (1957) (detailing the events that led to the enactment of the National Bank Act).


34. 12 U.S.C. §§ 1463(g), 1831a(b), 1831d(a) (2000); see also Federal Deposit Insurance Corporation Notice of General Counsel’s Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17 1998) (interpreting section 27 of the Federal Deposit Insurance Act as providing state-chartered, federally insured banks the same interest rate exporting powers as those granted to national banks under section 85 of the National Bank Act).

35. *Nat’l Consumer Law Ctr.*, supra note Error! Bookmark not defined., § 3.4.5.1.1, at 74–75 (discussing the effect of “sister-state” preemption).
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. The end result was what James White called a trompe l’œil—a grand illusion.

Every state in the union, save two, had relatively aggressive usury laws on the books, but these laws no longer applied to any bank in the country.

That being said, at the beginning of the 1980s, state usury limits did still apply to non-bank lenders. Finance companies, car dealerships, retailers, and even mafia loan sharks were still legally required to comply with the traditional usury limits. Non-depositary finance companies resented the special treatment of banks and in many states began agitating for their own special exceptions to the old small loan laws. High inflation and prevailing interest rates in the late 1970s raised lenders’ cost of funds, made these lobbying efforts, at least temporarily, more persuasive.

With prevailing prime interest rates in the double digit range, making profitable consumer loans was difficult under some of the lower traditional interest rate caps. This unusual macroeconomic pressure along with well funded state-by-state lobbying campaigns persuaded many state legislatures to adopt more expansive usury limit exceptions.

While payday lending had historical forebears both in the U.S. and around the world, the industry reinvented itself in this period by deferring the deposit of borrowers’ personal checks. 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. The lender would, in turn, would “cash” the check by giving the borrower the face amount of the check less a finance charge. After two weeks went by, the borrower could buy back the check by bringing cash into the payday lender’s store, or simply allow the lender to deposit the check. In many states, payday lenders insisted they did not make loans, but rather were simply cashing checks. In other states, payday lenders teamed up with a handful of banks to “rent” the bank’s Marquette powers. The payday lender would do the marketing, intake, collections, but would pay a fee to a bank for permission to nominally make


37. See White, supra note 32, at 445–48.


the loan in the name of the bank. Eventually, the federal banking regulators cracked down on these practices by issuing guidance that deferred check cashing is a form of lending governed by the Truth in Lending Act and that “charter renting” to avoid usury limits is an unsafe and unsound banking practice. 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 455 percent, payday loans were actually much more expensive than the old mafia loan sharks that typically charged a relatively mild 250 percent.

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. 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.

40 See People v. County Bank of Rehoboth Beach, Delaware, 2007 WL 4127132 (N.Y.A.D. 3 Dept. 2007); Jenkins v. First Am. Cash Advance of Georgia, 400 F.3d 597 (11th Cir. 2007).
44 Federal Deposit Insurance Corporation, An Update on Emerging Issues in Banking: Payday Lending, Jan. 29, 2003, http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html (“Industry analysts estimate that the number of payday loan offices nationwide increased from less than 500 in the early 1990’s to approximately 12,000 in 2002, with continued growth expected.”).
payday lending outlets roughly quadrupled in four years, growing from 307 in 1997 to 1204 in 2000. Wyom ing payday lenders almost tripled between 1996 and 1997. Payday lending outlets quintupled in Salt Lake City between 1994 and 2000. In Iowa payday lenders locations grew eightfold in only two years. Nationwide, the number of payday lender locations more than doubled from 10,000 to 22,000 between 2000 and 2004 alone. 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. Georgia, New Hampshire, Oregon, and the District of Columbia have taken similar measures. In Arkansas, the state Supreme Court used the state’s constitutional interest rate cap to
overturn legislation authorizing payday lending.\textsuperscript{56} In Ohio, Arizona, and Montana the public has voted to reestablish traditional price limits on state ballot measures.\textsuperscript{57} At the federal level, Congress created the first national usury limit capping interest rates chargeable to military service members at 36% per year.\textsuperscript{58} And, of course, several states, particularly in the northeast, have maintained a steady commitment to traditional usury limits.\textsuperscript{59} Still, in many more states usurious lenders have managed to forestall a return to traditional American law with a variety of cosmetic rules that do not provide meaningful consumer protection. It is these states which have set the stage for a growing trend of municipal and county leadership.

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

The government relations and marketing wings of financial services companies have long talked at cross purposes. When consumer financial services companies speak to legislatures, regulators, and courts they tend to extol faith in the ability of financial markets to resolve to efficient outcomes. The hallmark of this consumer finance advocacy has always been the Adam Smith’s “invisible hand” guiding allocation of resources to a collectively optimal outcome through individuals’ rational, self interested decisions. However, when the sales and marketing wings of financial services firms communicate with prospective borrowers, the unmotivated invisible hand is replaced by a calculated effort to persuade and sometimes to confuse or mislead. Consumer finance marketing focuses less on the relationship supply to demand than the formation and manipulation of consumer decision making.

\textsuperscript{56} McGhee v. Arkansas State Bd. Of Collection Agencies, 289 S.W.3d 18, 27 (Ark. 2008) (“Because the Act so clearly authorizes usurious interest rates, it cannot stand.”).

\textsuperscript{57} See infra note X. Despite these referendums, the payday lending industry is actively attempting to circumvent public will in Ohio and Arizona by exploiting loopholes not closed in the precise wording of the ballot measures. See Jim Hawkins, The Federal Government in the Fringe Economy, 15 CHAP. L. REV. 23, 74-75 (2010).


\textsuperscript{59} CONN. GEN. STAT. § 36.-563 (2004); MD. CODE ANN., COM. LAW § 12-306(0)(2)(i); MASS. GEN. LAWS. ch. 140, § 100 (Supp. 2007); 209 MASS. CODE REGS. 26.01 (2007); N.J.STAT. ANN § 2C:21-19; N.Y. PENAL LAW § 190.40; 7 PA. CONS. STAT. ANN. § 6213; VT. STAT. ANN. tit. 9, § 410 (Supp. 2007).
instincts, wants, and urges as reasons to borrow. 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. The characterization of financial services markets as driven by rationally comparing the value of one financial service product to others is highly inaccurate. While some borrowers make rational, self-interested, informed decisions on the value of each loan in comparison to its opportunity cost, many do not. At least seven common human psychological patterns create opportunities for predatory lenders to induce contracts that may not be in the best long-term interests of their borrowers.

First, consumers from all walks of life systematically underestimate their exposure to human problems and overestimate their ability to make risk judgments. Because people have difficulty accepting their own vulnerability, most chronically underestimate their chances of heart attacks, asthma, lung cancer, being fired from a job, divorcing within five years after marriage, attempting suicide, and contracting a venereal disease. Workers overestimate their legal protections against employers’ arbitrary firings. Even sophisticated managers are prone to treat decisions as unique, generating unreasonably optimistic forecasts by ignoring or

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minimizing past results. Moreover, even when consumers actually overestimate the probability of emergencies, they typically “think that they personally are peculiarly less susceptible to such events.” 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.

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. Moreover, there is robust evidence that borrowers chronically underestimate the cost of credit, even in the face of price disclosures. Credit card borrowers tend to make foolish choices about contractual terms because they are systematically unrealistically optimistic about their future card use and personal circumstances. Federal Reserve Board researchers looking at data for the past 30 years in all demographic groups find credit cardholders’ opinions “about their own experiences are almost the reverse of their views about consumers’ experiences in general, suggesting considerable concern over the behavior of others and a belief that ‘I can handle credit cards, but other people cannot.’” A study relying on point of sale interviews reports that triple- and quadruple-digit interest-rate payday loan borrowers were

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“hopelessly optimistic in terms of when they expected to be able to repay
the loan, particularly at the beginning of the relationship.” 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.

Second, many consumers tend to focus on the present benefits of their
actions, while underestimating or ignoring longer-term drawbacks. People
have an innate difficulty maintaining self-control in the face of immediate
gratification. They tend to prefer a benefit that arrives sooner rather than
later, in effect “discounting” the value of the later reward. 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. This bias creates difficulty for consumers in attempting
to order their financial affairs. The abstract nature of financial pricing
makes self-control particularly difficult. For example, saving when an
asset is highly liquid is hard. 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. 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 than they actually will be.

71 Nathalie Martin, 1000% Interest Rates—Good While Supplies Last: A Study
of Payday Loan Practices and Solutions, 52 ARIZONA L. REV. 536, 622 (2010).
72 Stango and Zinman, supra note X, at X.
73 Richard. H. Thaler, Some Empirical Evidence on Dynamic Inconsistency, 8
ECONOMIC LETTERS 201 (1981).
74 Shane Frederick, George Loewenstein, and Ted O'Donoghue, Time
LITERATURE 351 (2002).
75 Lawrence M. Ausubel, The Failure of Competition in the Credit Card
Market, 81 AM. ECON. REV. 50 (1991); Philip Bond, David K. Musto, and Bilge
Yilmaz, Predatory Mortgage Lending, 94 J. OF FIN. ECON. 412 (2009).
76 Adam Gifford, Jr., Emotion & Self-Control, 49 J. OF ECONOMIC BEHAVIOR
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77 David Laibson, Golden Eggs and Hyperbolic Discounting, 112 QUARTERLY
78 Brigette C. Madrian & Dennis F. Shea, The Power of Suggestion: Inertia in
79 Gretchen B. Chapman, Temporal Discounting and Utility for Health and
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Third, consumer lending markets are likely to be distorted by distressed abbreviated reasoning patterns. Psychologists report consumers who are suffering from emotional distress, embarrassment, desperation, or fear frequently make poor decisions regarding values and risk. People’s impulse control breaks down when they face emotional distress. 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. Because many consumers are in the market to borrow money precisely to deal with some financial threat, they are likely to lack the attention required to resist the temptation of a temporary financial “quick-fix.” Moreover, the most vulnerable loan applicants tend to have problematic credit histories, which lead them to evaluate loan pricing while fearing the embarrassment and rejection. These conditions are likely to inhibit loan applicants’ ability to adjust their perceptions of price as they learn about loan terms.

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. 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

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to understand the information at all. Moreover, when borrowers lack experience or understanding of financial and legal terms of loan contracts, the opportunity cost of comparing shopping from multiple creditors can be quite high, suggesting that careful comparison may not even be rational for borrowers who have literacy and numeracy challenges. The U.S. Department of Education’s most recent national survey of adult literacy finds that 22 percent of American adults lack even the most basic quantitative literacy skills. 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. Indeed, at least one analysis of the subprime mortgage crisis reports a strong correlation between numerical ability and foreclosure.

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. 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. Consumers treat identical investment risks differently depending on whether they are presented as a gamble or insurance. These

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86 Peterson, Taming the Sharks, supra note X, at 131 (“The costs of acquiring information must be evaluated relative to the resources of credit shoppers.”).
patterns exist and can be manipulated in consumer financial services markets. For example, “[i]ndividuals will perceive a penalty for using credit cards as a loss and a bonus for using cash as a gain; this although the two situations are, from an economic and end-state perspective, identical.”

Payday lenders prefer to describe their loan prices as a percentage of the loan principal, rather than with a simple nominal annual interest rate because, for example, borrowers are likely to perceive a two week loan with a price of 15 percent of the amount financed as less expensive than a the same loan with a 391 percent simple nominal annual interest rate—even though these prices are in fact identical.

Moreover, people tend to rely too heavily on first impressions when assessing risk and value. 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. For example, research suggests anchoring on the early estimate of the value of a lawsuit tends to disrupt later settlement negotiation. Even accountants conducting audits anchor on early estimates and insufficiently correct their judgments. Marketing professionals have absorbed these lessons and systematically design sales tactics to exploit this pattern in judgment making.

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 loses as they are pleased with equivalent gains. A related tendency makes consumers willing to assume an objectively inordinate amount of risk when facing the loss of something they already possess. For example, people who have owned antique furniture or vintage wine for a long period of time commonly refuse to sell their possessions for prices far greater than market value—even though they could buy a replacement and pocket the difference. Some economists explain this is because the owners have “endowed” their possessions with personal value. 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. 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. Similarly, homeowners that have fallen behind on mortgage payments will often agree to onerous terms refinancing their homes in order to avoid foreclosure.

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

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102 Peterson, TAMING THE SHARKS, supra note X, at 175.

resources as a self-control mechanism—terminating a gambling binge, for example, once the consumer has no more money left. 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. Moreover, these behavioral weaknesses may be more pronounced in consumer finance markets than the markets for some other products and services. Unlike the homogeneous pricing of most goods, consumer loans are underwritten to the needs and abilities of individual borrowers, giving lenders the opportunity to heterogeneously price loans based on the inabilitys and misunderstanding of loan applicants. In many markets, shoppers discipline pricing and quality. But in consumer finance markets, lenders can segment the market based on consumer vulnerability, rather than on product quality.¹⁰⁴

In addition to behavioral research, some scholars have attempted to explore the welfare effects of high cost, small consumer loans. However, this research is notoriously difficult for a variety of reasons. Borrowers are often embarrassed and confused regarding their financial circumstances and are reluctant or unable to self report their difficulties. This borrower population is also likely to be more mobile than many populations, changing jobs, addresses, and telephone numbers more frequently than more affluent families introducing difficulties in tracking borrowers over longer durations. Payday and car title lenders have not historically reported their repayment patterns with the national credit bureaus and many borrowers in this market are not plugged in to the mainstream economy in the same way as more affluent people. It is challenging to separate out the effects of other financial stressors and demographic forces in borrowers’ lives. Many studies have been unable to account for local, regional, and national changes in labor markets; the effects of the housing bubble and crisis over the past fifteen years; and the complex dynamics of other social forces that effect low and moderate income communities such as crime, drug addiction, divorce rates, the number of dependents per wage earner, educational levels, educational quality, military service, and racial discrimination. Many families are profoundly affected by the fluctuating cost of gasoline, the rising price of health care, declining access to health insurance, all of which exist across complex temporal, spatial, legal, and social patterns. Studies of payday and car title lending must also contend with causal noise created by other forms of credit, asset accumulation, and asset protection including credit cards, bounce protection plans, pawnshops, installment loans, negotiating delayed payments with creditors, credit union

programs, peer-to-peer online lending, family support networks, and saving accounts, and the ability of borrowers to evading creditor collection remedies. Many studies make no effort to account for how the differences in unsecured creditor remedies in various legal jurisdictions. The growing use of payday loans legally and illegally offered over the Internet also clouds studies on the effect of laws regulating small loan markets. Even in states where the state government is attempting to collect useful data, many members of the small loan industry actively evade these reporting requirements as well as the consumer protection laws that generally go along with them. The civil justice system does not generally provide useful information about this market because the size of loans often makes litigation cost-prohibitive from borrowers’ perspectives. Many payday and car title lenders have iron-clad arbitration agreements that force borrowers into secret private dispute resolution. And most of all, the people who could supply the information to overcome these hurdles—payday and car title lenders themselves—generally refuse to release their loan data.

Nevertheless in recent years researchers have released a growing number of papers, some of which have been published, that purport to show both beneficial and harmful effects of payday lending. While a complete exposition of this growing body of literature is beyond the scope of this Article, a few illustrative examples are helpful. For instance, the payday lending industry has widely distributed an unpublished working paper written by Donald Morgan and Michael Strain.¹⁰⁵ Morgan and Strain concluded that the re-imposition of traditional interest rate limits in North Carolina and Georgia led to: greater rates of bounced checks than the national average; more complaints to the Federal Trade commission about lenders and debt collectors; and, Chapter 7 bankruptcy filing at rates greater than the national average.¹⁰⁶ However, consumer advocates at the Center for Responsible Lending aggressively challenged the study’s methods.¹⁰⁷ 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.¹⁰⁸ But, these regional returned check rates indistinguishably mixed in returned checks from Alabama, Louisiana, southern Mississippi, South Carolina, and Tennessee—all of whom had legal and rapidly growing payday lending

¹⁰⁶ Id. at 26.
¹⁰⁸ Morgan & Strain, supra note X, at 3.
industries during the study period. Moreover, the study did not control for a host of other independent regionally related factors that could have accounted for a very small reported increase in bounced checks across the region including, for example, hurricane Katrina. 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. Even more problematic was the studies 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, divorce rates, [and] demographic factors such as income.” Despite all these limitations (as well as the author’s disclaimer that its findings were “preliminary” and shared “solely to stimulate discussion”), the Morgan and Strain paper remains notable because industry lobbyists have so frequently supplied the piece to state legislatures and quoted it in the press that it remains the most prominently discussed proxy welfare variable study to date.

In contrast, Brian Melzer’s more recent study published in the *Quarterly Journal of Economics* measures the effects of payday loan availability on borrower well being. Using a clever study design Melzer focused on families from states that effectively banned payday lending, but nonetheless had access to payday loans because they lived just over the border of a state that allowed payday lending. 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. Melzer measured borrower well being with self-reported variables including: postponed medical care, postponed dental care, postponed prescription drug purchases; difficulty paying mortgage, rent or utility bills; moving out of one’s home due to financial dificult; skipping meals; and, going without telephone service. Melzer conducted a variety of different regressions to discover whether access to payday loans caused an increase in hardship. In addition to baseline regressions, also did regressions one focusing on differences in payday loan access over time and another measuring focusing on different

109 Center for Responsible Lending, *Critique of “Payday Holiday,”* supra note X, at 4, 110 *Id.*
111 *Id.*
112 *Id.*
115 *Id.* at 518-19.
116 *Id.*
117 *Id.* at 525-26.
income groups, both of which confirmed his baseline results. Melzer found compelling evidence that families with access to payday loans were more likely to have difficulty paying their bills, to skip meals, and live without access to a telephone. His results suggest, for example, that the likelihood of reporting difficulty paying bills increases by 25% for families with access to payday loans. Melzer also found that families with access to payday loans were more likely to suffer health related hardship by postponing medical and dental care, as well as forgoing prescription drug purchases.

Similarly, Kurbin, Squires, and Graves recently published a study in the *Journal of Criminology and Public Policy* that found evidence showing the density of payday lending locations causes an increase in local crime rates. They mapped payday lender locations and compared these locations to reported violent and property crime rates in census tracts within the Seattle area regressing for a broad array of independent variables that included: percent secondary low-wage jobs, the jobless rate, the percent of employed people working as professionals or managers, the percent of high-school graduates, the poverty rate, the percent of Black people, the percent of young males, a residential instability index, the percent of female headed households, and population—all of which have been shown to be related to community crime rates. This study attempted to account for multicollinearity between the independent variables, spatial auto correlation, and endogeneity between crime and payday lender density. In three different regression models the study found that “payday lending is significantly associated with both violent and property crime rates. This relationship holds even after controlling for a host of factors typically associated with neighborhood crime rates.” The study asserted that “payday lending imposes broader community costs” that “all residents pay

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

119 *Id.* at 534.

120 *Id.* at 550.


122 *Id.* at 444-46.

123 *Id.* at 456.
when they reside in neighborhoods with a concentration of payday lenders."124 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,125 which suggests that payday lending locations may depress property values.126 This claim will not surprise many local government leaders around the country who have frequently asserted the same point.127

While the social science is by no means unanimous, the best evidence suggests that small high cost loans are harmful to borrowers and their communities on balance. Given the complexity of the research, local government leaders can be excused for indulging the impulse to trust their instincts, their values, and their own common sense. We have a long legacy of many of our most respected leaders and profound thinkers rejecting the notion that consumer lending markets are naturally efficient. For example, while the early American founding fathers were passionately committed to the value of freedom, they had virtually no confidence in the inherent efficiency of financial markets. President George Washington, the father of our country, explained, “there is no practice more dangerous than borrowing money . . . for when money can be had in this way, repayment is seldom thought of in time . . . Exertions to raise it by dint of industry ceases. It comes easy and is spent freely and many things indulged in that would never be thought of, if to be purchased by the sweat of the brow. In the mean time, the debt is accumulating like a snowball in rolling.”128 Thomas Jefferson, author of the declaration of independence, famously feared banks

124 Id. at 457.
126 Kurbin, et al., supra note X, at 458.
127 See, e.g., Editorial, Some Firms Hurt Neighborhoods, OMAHA WORLD-HERALD, February 4, 2009 (“Asked why neighborhood associations don't support whatever businesses choose to locate within their borders or on their periphery, our answer is quite simple. When zoning laws enable predatory businesses to fill in the empty storefronts of our neighborhoods, we see increased crime, decreased property values and neighbors afraid to walk outside their doors after dark. Predatory businesses : like payday loan operations . . . prey on those whose ties to society already are weakened.”); Annya Johnson, Payday Loan Stores in Crosshairs: Tosa imposes one-year Moratorium While it Studies Permanent Restrictions, MILWAUKEE J. SENTINEL, September 21, 2006 (“Wauwatosa's moratorium is in response to neighbors' complaints that the . . . [payday loan] store would attract crime and lower property values.”);
more than standing armies. And, Benjamin Franklin, the principal advocate of the bill of rights wrote:

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

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

Indeed, Adam Smith himself, lacked confidence in the efficiency of consumer finance markets. Instead of relying on his own insights into naturally efficient markets, Smith emphasized the importance of overconfidence bias in financial decision-making stating that, “[t]he overweening conceit which the greater part of men have of their abilities is an ancient evil remarked by the philosophers and moralists of all ages . . . The chance of gain is by every man more or less over-valued and the chance of loss by most men undervalued . . .” 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 indispensable. 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. Instead Smith argued that usury limits should be set “somewhat above . . . the lowest market rate.” With respect to high cost loans, the inventor of the invisible hand did not believe in the invisible hand.

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


131 ADAM SMITH, WEALTH OF NATIONS 164 (1776).

132 *Id.* at 147.

133 *Id.* at 147.
III. ZONING IN THE VOID: THE LOCAL RESPONSE TO PREDATORY SMALL LOANS

Like Adam Smith, many local government leaders believe usury laws to limit prices in the market for small consumer loans. To this effect, many local governments feel compelled to fill the void in leadership on predatory lending in the absence of effective state and federal action. Moreover, because public opinion favoring limits on small loan pricing has proven more durable than the limits themselves, local leaders face significant constituent pressure to respond to payday and car title lending. In the past few years, at least one hundred and thirty-five local governments have attempted to restrict, regulate, or otherwise arrest the development of usurious lending within their boundaries. Local governments with starkly different political and demographic profiles have reached similar conclusions regarding the need to inhibit predatory small loans within their neighborhoods. For example, San Francisco, one of the nation’s most liberal cities, has adopted a fringe lending ordinance very similar in approach to those found in small, conservative towns like Little Elm, Texas, and American Fork, Utah. Even still, this significant groundswell of local support for restrictions on predatory small loans likely understates the actual support for regulation because the limits on local government power probably deters some governments from acting.

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. 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.

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136 See, e.g., Dallas Council Urged to Limit Payday Lending Sites, Dallas Morning News, January 4, 2011 (“Council member Tennell Atkins, who's far southern Dallas district is home to dozens of payday-lending stores, said he's ‘125 percent against them.’ But a resolution to the Legislature may be an empty gesture, he said. The industry's powerful lobbying arm has spread hundreds of thousands of dollars to elected officials in Austin, he said.”).
137 U.S. CONST art. VI, cl. 2 (“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”).
138 See infra notes X through X, and accompanying text.
Moreover, statutes adopted by state legislatures can, in some contexts, also preempt local ordinances.\(^{139}\)

Nevertheless, local governments do retain some powers traditionally reserved for local governments. Some local leaders have aggressively pushed the outer boundaries of these powers by attempting to altogether eliminate predatory small loans within their cities or counties. For example, in 200X Jacksonville, Florida adopted an ordinance attempting to cap payday loan prices. Florida state law generally imposes a usury limit of 18\%.\(^{140}\) Lenders exceeding this price cap without a license are subject to criminal prosecution.\(^{141}\) But, the Florida legislature has also granted licenses to payday lenders allowing them to charge fees amounting to an interest rate of around 300\% on a typical payday loan.\(^{142}\) 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.\(^{143}\) 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.\(^{144}\) 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.\(^{145}\) Nothing in the state’s payday lending statute explicitly contradicted this interpretation. Nevertheless, when a payday lender challenged the city’s ordinance, a state trial judge struck down the price cap holding that the state legislature had intended to preempt local price regulation.\(^{146}\)

Less direct than Jacksonville, St. Ann, Missouri, a small suburb of St. Louis, attempted to prevent triple digit payday lending within its city by framing it’s prohibition as an exercise of municipalities’ traditional right to use zoning law for land use planning.\(^{147}\) The Missouri legislature has adopted a statute that authorizes licensed payday lenders to collect interest

\(^{139}\) See infra Part IV.A. for a discussion of the law of state preemption of local ordinances.

\(^{140}\) See FLA. STAT. ANN. §§ 687.02(1), 687.03(1).


\(^{142}\) Id. § 560.404(6).

\(^{143}\) Peterson, Salience Distortion, supra note X, at 1152.

\(^{144}\) Advance America, Cash Advance Centers of Florida, Inc. v. The Consolidated City of Jacksonville, Florida, Fourth Judicial Circuit Court, Duval County, Case No.: 16-2005-CV-7025-XXXX-MA, Division CV-D (June 1, 2006).

\(^{145}\) Id.

\(^{146}\) Id.

\(^{147}\) Griffith, Hilton, and Drysdale, supra note X, at 26.
and fees up to 75% of the initial principle of any single loan. While there is some ambiguity in the statute, the law’s most simple interpretation appears to authorize accrued interest of 75% of the loan principle which in typical two week payday loan of $325 constitutes an astounding annual interest rate of 1955.36%. 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. Such business is prohibited in all zoning districts of the City of St. Ann.

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

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

148 MO. REV. STAT. §§ 408.100, 408.505(3) (Supp. 2011).
149 Peterson, Salience Distortion, supra note X, at 1139.
151 Id. at 314
152 Id. at 314
153 Resolution No. 3202, § 1, Sachse, Texas (April 5, 2010) (“'[T]he City of Sachse urges the Texas State Legislature and the Governor of Texas … to enact laws that will … [c]lose the loophole in state law that allows payday, auto title, and other consumer loans to carry annual percentage rates upwards of 500%.’”) (emphasis in original).
While Jacksonville and St. Ann serve as examples of ordinances that did not survive judicial challenge, there are many more local governments that have taken measures that do remain in force. In recent years, local governments have turned to their well accepted power to adopt zoning ordinances to stem the tide of payday and car title lending within their jurisdictions. These zoning ordinances tend to take one or more of three basic forms: (1) restrictions on the location where predatory lenders can operate; (2) discretionary permits that restrict who may obtain licenses to engage in predatory lending; and (3) permanent or temporary limits on the number of predatory lending locations within a jurisdiction.

First, perhaps the most common local restriction on predatory lending outlets is limits on where lenders can locate. Some jurisdictions restrict the proximity of predatory lenders to residences, churches, schools, or other protected buildings. For example, Jacksonville, Florida now prohibits the location of payday lenders within five miles of an active military installation.155 Some local governments also restrict predatory lenders from clustering together by requiring a minimum distance separating locations.156 There is considerable variety in the required minimum distance, with some leaders adopting a cosmetic six hundred feet and others requiring as much as a mile of separation.157 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.158

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

157 Compare West Valley City Code, § 7-1-103 (30) with Sandy City Code, § 15A-11-20(A)(1) (stating that non-depository financial institutions “shall not be located within 5,280 feet (one mile) of the same type of use inside or outside of Sandy City geographical boundaries.”).
158 Ordinance No. 3147,§ 11.2(c)(1), Sachse Texas, July 6, 2007.
Third, some jurisdictions have explicitly limited the number of predatory small loan locations that may exist within their community. For example, the leaders of St. Ann, Texas, who unsuccessfully attempted to prohibit all payday lenders in their town, have since limited payday lenders to no more than three locations. Some cities and counties have adopted limits relative to the population. For example, West Valley City, Utah has an ordinance limiting payday lenders to no more than one store per ten thousand residents. Still, other governments have adopted temporary moratoriums prohibiting new locations while they study and debate how to respond to predatory lending.

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

159 Griffith, Hilton, & Drysdale, supra note X, at 29.
160 See, e.g., Ruth Ingram, Business Bans Still In Effect in Clinton, Clinton-Ledger (Jackson, Miss.), March 15, 2010, A9 (discussing Clinton, Mississippi moratorium on new payday loan stores).
162 See, e.g., Ordinance No. 10-1626, §(2)(D) Norwalk, California (February 23, 2010) (“Any payday loan establishment lawfully existing prior to the effective date of the ordinance that codifies this section and which is licensed by the City of Norwalk, shall be allowed to remain on the same property . . . .”).
But perhaps the most unsatisfactory result of local ordinances is their propensity to demobilize efforts for more meaningful change. Zoning ordinances have been relatively easy to pass precisely because predatory lenders do not view these rules as a threat to their activities. In reality, while zoning ordinances do very little to protect vulnerable families from abusive financial products, they do provide political cover for leaders that do not want to risk offending the powerful predatory finance lobby. Well intentioned local governments can declare a “victory,” congratulate 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.  

V. PLAINSPoken LEADERSHIP: A PROPOSAL FOR CAUTIONARY SIGNAGE ORDINANCES

This Part proposes a local ordinance strategy through which local leaders could both provide meaningful consumer protection and send a strong message mobilizing their community toward traditional limits on predatory loans. Appendix A, which follows this Article, includes a Model Small Predatory Lending Ordinance. This ordinance proposes that local governments require a cautionary message on signs at businesses offering credit at annual percentage rates exceeding 45%. 165 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 cautionary message that reads: “Warning: Predatory Lender.”166 The ordinance requires the display of this cautionary message over a third of the spatial area on each exterior sign.167 The ordinance requires that the text of the cautionary message be white on a black background.168 While proposed ordinance requires predatory lenders display the warning on any of their exterior signs, the warning is not required if the lender forgoes exterior signage.169 Thus, the warning requirement is tailored to match the degree to which a predatory

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

165 Infra Appendix A, at § 600.
166 Id. at § 600(b).
167 Id.
168 Id.
169 Id. § 600 official comment 2.
lender advertises at its location. The amount of required warning signage matches the amount of predatory lending advertisement chosen by the predatory lender.

Second, the ordinance requires the display of official door signs created and distributed by the director of a city or county department charged with enforcing the ordinance. The ordinance requires display of these door signs on all exterior doors of a predatory lending facility. 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. But, the cautionary door sign also includes an additional explanation indicating that: the city or county in question has determined that the facility displaying the sign engages in predatory lending; that the local government required predatory lending warnings on displayed signs under a consumer protection law; that the lender offers loans at interest rates above 45%; and, a statement indicating that “These loans can cause bounced checks, penalty fees, repossessions, lawsuits, and severe financial hardship.”

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

There is no question that predatory lenders will be incensed by the proposed predatory small loan ordinance suggested in this Article. But, their
A visceral reaction is born from the painful reality of their commercial behavior. The truth of what these businesses have become is hurtful. Despite their public relations and government lobbying efforts to the contrary, lenders that charge exorbitant interest rates to American families are false friends of the working poor and middle class. While these lucrative companies have, in many instances, invested their profits in forging their polished corporate brands, local government leaders are under no obligation to play along with efforts to camouflage abusive loans. Indeed, as President Regan once explained, “To grasp and hold a vision, to fix it in your senses - - that is the very essence, I believe, of successful leadership…” The proposed ordinance in this section is useful because it provides a reoccurring, simple, and boldly featured message of warning to potential victims of abusive commercial behavior. Instead of confusing, numeric information that many Americans cannot understand, the proposed ordinance clearly signals the danger associated with predatory loans. High cost lenders will object to this warning not because it is inaccurate, but because they realize its power and effectiveness.

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

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

182 *Id* at § 892(a).
183 The conference report of the Consumer Credit Protection Act justifies the 45% evidentiary threshold thus:
behavior is inclined to injure or exploit for personal gain or profit.\textsuperscript{184} For over 40 years, federal law has held that loan prices in excess of 45\% are indicative of illicit and exploitative intentions.\textsuperscript{185} Because Congress has used this threshold as a legal device suitable, in part, for determining when high cost lenders should be incarcerated, it is also appropriate as a threshold in warning potential victims of the likelihood of this potentially criminal and predatory behavior.

Second, while the 45\% evidentiary threshold in federal law does not, by itself, establish a criminal limit, many other federal and state laws both today and in the past, use an interest rate limit as the conclusive standard of illegal and in many states criminal behavior. For example, federal law establishes a 36\% APR usury limit on loans made to military service members and their dependents.\textsuperscript{186} 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.\textsuperscript{187} 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\%.\textsuperscript{188} Georgia punishes violations of its usury limit with up to a year in prison.\textsuperscript{189} Similarly, in Florida, the label “loan shark” is a legal term of art defined by statute.\textsuperscript{190} Unlicensed lenders in Florida are guilty of misdemeanor “loansharking” when they willfully lend at annual interest rates in excess of 25\%.\textsuperscript{191} Unlicensed lending at interest rates of

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

U.S. House of Representatives, Consumer Credit Protection Act Conference Report, Report No. 1397, 90\textsuperscript{th} Congress, 2\textsuperscript{nd} Session, p. 30, May 20, 1968.\textsuperscript{184} Merriam Webster’s Dictionary.


Peterson, Salience Distortion, supra note X, at X.

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

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

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

Id. § 687.071(2) (Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take, or receive interest thereon at a rate exceeding 25 percent per annum but not in excess of 45
above 45% is punishable as a third degree felony. 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 effective and prominent warning to borrowers that do not enjoy the benefit of comparable protections.

Given the tradition and current laws of many states that outlaw loans at interest rates lower than 45%, some local government leaders will view this threshold as set too high. Arguably, it would be more appropriate to set the threshold limit at 36% to mirror the most common American small loan limit throughout the twentieth century, as well as the federal cap on loans to military service members. Moreover, there are many financial practices that are fairly characterized as predatory independent of a 45% interest rate threshold. For example, other abusive payday loan features and practices include: making loans without considering to borrowers’ ability to repay; imposing balloon payments that force repeated refinancing; using checks or automated clearing house debit authorizations to coerce repayment; imposing pyramid 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. 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.

192 Id. § 687.071(2) (“Unless otherwise specifically allowed by law, any person making an extension of credit to any person, who shall willfully and knowingly charge, take, or receive interest thereon at a rate exceeding 45 percent per annum or the equivalent rate for a longer or shorter period of time, whether directly or indirectly, or conspire so to do, commits a misdemeanor of the second degree . . . .”).
193 Peterson, Salience Distortion, supra note X, at X.
Questions are likely to be raised regarding whether a variety of consumer loans fall within the scope of the proposed model ordinance. For example, tax refund anticipation loans, unsecured finance company loans, and pawnshop loans can sometimes carry interest rates in excess of 45%. Importantly, all of these forms of credit can be offered with more modest prices when combined with responsible underwriting and reputable collection methods. But, insofar as federal Truth-in-Lending law characterizes these forms of credit as carrying an Annual Percentage Rate exceeding 45%, the model ordinance as written will require the same signage warnings that will almost certainly be imposed on typical payday and car title lending companies. Some lenders and merchants are likely to demand special exceptions under a proposed ordinance. However, making an exception for one type of merchant, practice, loan term, or another, will open the door to claims of an unlevel playing field. It will ultimately erode the clear, bright line that is one of the primary advantages of the ordinance. By hinging the ordinance on federal law, local governments would harness a pre-existing body of law that has already had many years of thoughtful interpretation by regulators and courts. In contrast, as language attempting to grant exceptions is introduced into the model ordinance, the likelihood of predatory lenders developing strategies to exploit loopholes will increase. A 45% Annual Percentage Rate trigger will provide a high, yet clear, bright line with low compliance costs for businesses and simple enforcement for both courts and local governments.

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

There is considerable variation in the powers granted to local governments to regulate commercial activity. Unlike sovereign state governments, courts regard local governments as administrative subdivisions of their states that do not have “inherent” powers. Some local governments have “home rule” authority generally thought to include all powers not expressly denied by state statute. Courts are, nevertheless, not in agreement on the nature of home rule powers. Home Rule Ordinances grant “Dillion’s rule,” which holds that local governments have only those powers “granted in express words” together with those powers necessarily

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197 2 LOCAL GOVERNMENT LAW § 13:1 (2009 & supp.).
implied or essentially granted by statute. 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.” Nevertheless, local governments may not enact ordinances which are inconsistent with state law or which infringe the spirit of state law. Generally speaking, a state statute preempts municipal ordinances when either the language in the ordinance contradicts the language in the statute or when the judiciary finds that the legislature intended to thoroughly occupy the field of regulation.

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. Most directly, in the past some courts recognized the authority of local governments to directly cap interest rates on consumer loans. Looking beyond the issue of price, courts have upheld local government authority to issue a wide variety of consumer financial services regulations. For example, Courts have generally upheld permitting requirements for pawnshops or other types of small consumer finance lenders. Permit requirements are usually upheld even where the permit is duplicative of a state license. And in some states the enforceability of contracts may be challenged where the lender failed to obtain a local permit. By way of example, the Nebraska Supreme Court

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200 Id.


203 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).

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


206 See generally 29 ALR4th 884 (discussing failure of a lender to obtain a permit upon the enforceability of the lender’s contracts).
upheld the right of a local government to require that small lenders file detailed weekly reports on every loan made to a city auditor.208 The Missouri Supreme Court held that local governments had the power to require that pawnbrokers take and maintain a photograph of each every customer pawning merchandise.209 Moreover, courts have generally upheld ordinances requirement imposition of local per-transaction fees on consumer lenders.210 Local law regarding consumer financial services can be enforced through criminal sanctions, even where those sanctions are complementary or duplicative of state statutes.211 And most recently, some local ordinances attempting to address predatory mortgage lending have been upheld as a valid exercise of a local power where not preempted by state statute.212

Moreover, courts have traditionally regarded ordinances regulating signs as particularly within the authority of local governments.213 For well over a hundred years local governments have been regulating merchants’ outdoor advertising.214 While authority to regulate signs is not unlimited, Courts have from early on been deferential to local signage ordinances. For example, Chicago won multiple litigation battles with billboard advertisers in the early twentieth century.215 Today there is an extensive jurisprudence granting local governments the power to regulate outdoor signs in virtually every state in the republic.216 Sign ordinances of many different types and purposes are routinely upheld including limits on their location,

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211 City of Hobbs v. Biswell, 473 P.2d 917, 920 (N.M. App. 1970) (“With the enactment of [a state regulation] … there is regulation of pawnbrokers by both the State and the municipality. The fact of double regulation does not result in the withdrawal of the municipality's authority to regulate. An ordinance may duplicate or complement statutory regulations.”).
215 City of Chicago v. Gunning System, 73 N.E. 1035 (1905); Thomas Cusack Co. v. City of Chicago, 108 N.E. 340 (Ill. 1915) aff’d 242 U.S. 526 (1917) (Ill. cities have authority to regulate billboards within city limits).
construction, maintenance, size and use. A leading treatise explains, that signage ordinances “[a]re to be sustained upon the basis of promotion of the public safety, convenience, comfort, morals, and welfare of inhabitants; more specifically, they constitute a legitimate exercise of the police power. . .” While the laws of each state are different, a New York Court explained, that municipalities traditionally have “wide latitude” to adopt ordinances concerning outdoor signs which are “presumptively valid.”

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

C. A Predatory Lender Warning Signage Ordinance is Constitutional

217 Id.
218 Id.
220 See, e.g., Utah Code Ann. 1953 § 7-23-401(1) (requiring lenders post “a number the person can call to make a complaint to the [Utah Department of Financial Institutions] regarding the deferred deposit loan.”).
The First Amendment states that “Congress shall make no law . . . abridging the freedom of speech.” In addition to Congress, the Fourteenth Amendment imposes the First Amendment’s freedom of speech restrictions on state and local governments. 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.” 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.” 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.”

In contrast, the Supreme Court has distinguished commercial speech from public discourse. While commercial speech also receives constitutional protection, the Court less closely scrutinizes this form of expression. The nature of constitutional scrutiny of commercial speech has been controversial and, in the view of some, inconsistent. Although the Court has had difficulty articulating the boundary between public discourse and commercial speech, in the seminal case of Central Hudson Gas & Electric Corporation v. Public Service Commission, the Supreme Court defined commercial speech as an “expression related solely to the economic interests of the speaker and its audience.” At other times the Court has pointed to “speech that proposes a commercial transaction” as the hallmark of commercial expression. Additionally, other cases have pointed to speech constituting an advertisement, speech that refers to a

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221 U.S. CONST. amend. I.
228 447 U.S. at 561.
product or service, and economically motivated speech as indicative characteristics of commercial expression. The Supreme Court has tolerated more aggressive state 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.”

Furthermore, government action that merely compels speech, such as warnings or disclosures, receives less constitutional scrutiny than restrictions of speech. The Supreme Court has explained that “[c]ommercial disclosure requirements are treated differently from restrictions on commercial speech because mandated disclosure of accurate, factual, commercial information does not offend the core First Amendment values of promoting efficient exchange of information or protecting individual liberty interests.” The Supreme Court has not viewed the withholding of commercial information, that is, the right not to speak as a fundamental right where a commercial speaker is marketing her services. 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.” Accordingly, “less exacting scrutiny is required than where truthful, non-misleading commercial speech is restricted.” 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.”

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231 Proctor & Gamble Co. v. Amway Corp., 242 F.3d 539, 549 (5th Cir. 2001).
233 Zauderer v. Office of Disciplinary Counsel, 471 U.S. 626, 652 (1985) (The right of a commercial speaker not to divulge accurate information regarding his services is not [a] fundamental right.).
234 Id. at 114.
235 Id. See also Riley v. Nat’l Fed’n of the Blind of N.C., 487 U.S. 781 (holding that “[p]urely commercial speech is more susceptible to compelled disclosure requirements” than is personal or political speech).
principles, courts have upheld “[i]numerable federal and state regulatory programs [that] require the disclosure of product and other commercial information.”

The proposed predatory lender warning ordinance is properly viewed by Courts as compelled commercial speech. Unlike, for example, signs and billboards used in political election campaigns the signs outside payday and car title lending locations are displayed entirely for commercial purposes. They are designed to solicit and encourage customers to borrow money. Moreover, the cautionary signage ordinance is itself designed to provide warning information to citizens that contemplate engaging in these entirely private transactions. The ordinance’s compelled speech does not affect how people interact with the state, nor does it affect the communication associated with lenders’ personal affairs. Moreover, 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. Weaker constitutional protection is entirely justified in “social settings that … involve persons who are deemed dependent, vulnerable, or not fully rational.”

Indeed, the proposed ordinance is reasonably designed to counteract misleading and deceptive speech of predatory lenders. Part III of this essay set out empirical evidence of common behavioral patterns that inhibit the ability of borrowers to make rational and fully informed decisions in this market. It is reasonable for local governments to conclude that a provocative and prominent warning is needed to counteract the ability of predatory lenders systematically manipulate borrowers’ less than fully rational behavior. Local governments are on a firm empirical foundation in believing that borrowers are unrealistically optimistic about their ability to repay high-cost debts aggressively marketed by predatory lenders. Local government leaders would be reasonable in finding that many borrowers would benefit from a strong cautionary message because of borrowers’ tendency to unwisely discount the value of future wealth and exhibit distress induced abbreviated reasoning patterns.

Moreover, local governments could reasonably conclude that many borrowers have great difficulty in processing and comparing even basic financial and legal information necessary to compare value in consumer finance. 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

239 See supra notes X through X and accompanying text.
240 See supra notes X through X and accompanying text.
fees,” “court costs,” “process service fees,” “filling fees,” and “attorneys fees.” For the millions of Americans that lack even basic 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 affect on true costs in comparison to more mainstream financial products. Many borrowers have virtually no incentive to comparison shop because they realize that they will not be able to spot the various tricks and traps predatory lenders lay for them in the inscrutable boilerplate legal provisions that accompany even relatively simple loans. A person of minimal quantitative and legal literacy may rationally recognize that the transactional costs of identifying which lenders have hidden tricks and traps within their adhesive boilerplate dwarf the potential utility from what may be a futile exercise in shopping. In a heterogeneously segmented market, there is no guarantee that any lender will offer a credit impaired borrower better terms, preferring instead to compete through aggressive collection practices instead of low transparent pricing. Moreover, borrowers’ perception of the incentive to incur shopping costs may be informed by the fact that in many consumer contexts, the law allows the businesses to unilaterally change the terms of a consumer’s deal after the fact anyway. Moreover, 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.

Even if payday and car title lenders somehow convince a court to apply constitutional scrutiny under the restriction of commercial speech standard set out in Hudson, the proposed predatory lending ordinance is nevertheless narrowly tailored. The ordinance 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, notwithstanding the warning requirement, predatory lenders would remain free to continue advertising their services in any non-deceptive way they choose to do so. 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

241 All fees are taken from sample payday loan contracts on file with author.
type of counteractive speech to be just the sort of “hardy breed of expression” that Courts need not be overly concerned with stifling.244

Predatory lenders’ best argument will be that the label “predatory” is so pejorative as to constitute a violation of lenders’ constitutional rights. However, local governments should argue that the word is an appropriate 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.” All levels of government in both political parties have adopted the use of the label “predatory” in describing some forms of lending. The label is commonly used by scholars and the press in describing lending regulated by the ordinance. 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. Indeed it would be an odd constitution that allows governments to incarcerate people to prevent predatory lending, but forbid those same governments from requiring strongly worded warnings that aim to do the same thing. Where a business solicits consumers to engage in a transaction 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. Indeed as Chief Justice Rehnquist explained, if courts hold otherwise, “[l]oan sharks might well choose States with unregulated small loan industries, luring the unwary with immune commercial advertisements.”245 Surely if the Chief Justice 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.”

VI. CONCLUSION

This Article has explored local government ordinances and resolutions that attempt to inhibit predatory lending within their communities. A growing trend of local government action has emerged following the failure of federal and state leaders to provide effective consumer protection laws. This vacuum in leadership on small, high cost loans has developed despite the great majority of Americans that support banning predatory loans. Federal and state preemption of local financial regulation have left local governments with limited authority to act on their constituents wishes. However, because local governments have traditionally had broad authority to regulate merchants’ exterior signage, this article suggests using that power to protect families from predatory loans. In particular, this Article

244 Proctor & Gamble Co. v. Amway Corp., 242 F.3d 539, 549 (5th Cir. 2001).
proposes a model ordinance requiring that lenders offering loans with annual percentage rates in excess of 45% display a cautionary message that reads “Warning: Predatory Lender,” on their street, storefront, and other on-premises exterior signs. While these signage requirements are in some respects unusual, this flows from the great disparity in the wishes of the public and the law as it has come to be controlled by the powerful business interests that exert pressure on key financial services committees in state legislatures and Congress. Providing a strongly worded message of caution on exterior signs to warn predatory loan borrowers would allow local governments to seize the initiative to help vulnerable families. Given the strong empirical, historical, and moral evidence suggesting that predatory small loans are destructive for borrowers, their families, and our communities, local government leaders should use their offices to protect the citizens that elected them.
APPENDIX A. MODEL PREDATORY SMALL LOAN ORDINANCE

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

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

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

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

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

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

WHEREAS, predatory lending locations increase crime; and

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

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

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

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

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

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

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Section 100. Title for Citation
Section 200. Legislative Findings
Section 300. Definitions
Section 400. Administrative Authority
Section 500. Licensing
Section 600. Signage
Section 700. Enforcement
Section 800. Severability

Section 100. Title for Citation
The ordinance codified in this chapter shall be known and may be referred to as the PREDATORY SMALL LOAN ORDINANCE.

Section 200. Legislative Findings
The [insert jurisdiction] Council finds as follows:
(a) There exist business practices, commonly referred to as “predatory lending”, whereby businesses lend small sums of money at usurious and unconscionable interest rates to low and moderate income persons and target members of our armed services and their families; and
(b) Small predatory loans had an unreasonably adverse effect upon the elderly, young families, the economically disadvantaged, and members of our armed services and their families, and other citizens of [insert jurisdiction]; and
(c) Many predatory loan borrowers lack bargaining power and financial experience and have difficulty evaluating the risks, prices, and consequences associated with high cost debts; and predatory loans cater to impulse borrowing that funds illicit drug use, gambling, and are otherwise deleterious of public thrift; and
(d) Predatory lenders falsely advertise their loans as fast and convenient, when in fact many borrowers fall captive to protracted cycles of repeat borrowing; and
(e) Predatory lending causes families to default on mortgage, rent, and utility payments; delay needed medical care; and lose bank their accounts; and
(f) Predatory lending locations increase crime; and
(g) Usurious lending is immoral and contrary to the values of the residents of [insert jurisdiction]; and Many less expensive and dangerous personal finance options are widely available to [insert jurisdiction] residents through banks, thrifts, credit unions, pawnbrokers, and merchants; and
(h) The federal government has determined that annual interest rates above 45% are indicative of predatory loan sharking; and
(i) Predatory lending was illegal and a criminal act throughout most of American history, including all thirteen original states, and in the state of [insert state]; and

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

**Section 300. Definitions**

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

**Official Comments:**

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

Section 400. Administrative Authority
(a) The Director is authorized and directed to enforce all provisions of this Chapter. The Director shall have the power to investigate any and all complaints regarding alleged violations of this Chapter. The Director may delegate any or all authority granted under this Section to any supervisor, employee, or agent.
(b) The Director is authorized to adopt and enforce administrative rules interpreting and applying this Chapter. The Director or designee shall make written findings of fact and conclusions of law to support all decisions.
(c) Prior to adoption of a new administrative rule, the Director shall give notice to all interested parties of the terms of the proposed rule, and shall conduct a public hearing to consider public comment. Public notices shall be given when administrative rules have been adopted.
   (1) At the public hearing, the Director or designee shall hear oral and written testimony concerning the proposed rule. The Director shall have the power to establish and limit the matters to be considered at the hearing, to prescribe procedures for the conduct of the hearings, to hear evidence, and to preserve order.
   (2) The Director or designee shall adopt, modify, or reject the proposed ruling after considering testimony received during the public hearing.
   (3) Unless otherwise stated, all rules shall be effective upon adoption by the Director.
   (4) The Director shall take reasonable and customary steps to make all final rules available to the public.
   (5) Notwithstanding subsections (1) and (2) of this Section, the Director may adopt an interim rule without prior public notice upon a finding that failure to act promptly may result in serious prejudice to the public interest or the interests of the affected parties. Such interim rules shall detail the specific reasons for such prejudice. Any interim rule adopted pursuant to this paragraph shall be effective for a period not to exceed 180 days.

Section 500. Licensing
(a) Within 90 days of the effective date of the ordinance enacted in this Chapter, any predatory lender operating in [insert jurisdiction] shall apply for and obtain a permit to operate as a predatory lender. Permits shall be required for each location a lender operates in [insert jurisdiction] and shall
be renewed annually. The application shall be in a form to be determined by the Director or the Director’s designee. No person shall operate a predatory lending business located in [insert jurisdiction] without a current permit to do business issued by [insert jurisdiction].

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

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

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

Section 600. Signage

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

(b) All exterior signs displayed at the business location of a predatory lender shall be modified to include the [insert jurisdiction] disclosure statement: “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 white Arial all capitals text on a black background.

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

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

(e) Official [insert jurisdiction] predatory lending door signs shall have white Arial all capitals text with a black 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.”

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

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

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

c. Roof sign:

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

Section 700. Enforcement

(a) The remedies provided herein are cumulative and supplementary and apply to licensees and unlicensed persons to whom this Ordinance applies even where they failed to obtain a permit as required.
(b) The Director shall have the authority to bring suit to enforce this Ordinance. A predatory lender found in violation of this Ordinance shall be liable for a statutory penalty of $10,000 per month per signage violation, together with any and all costs and attorney fees incurred by [insert jurisdiction] in enforcing this Ordinance.
(c) Any borrower who obtains a loan from a predatory lender in violation of this ordinance shall have the right to enforce the provision of this ordinance through an individual or class representative lawsuit. A predatory lender found to have violated this ordinance shall be liable to each borrower for actual, consequential, and statutory damages of $2000 for each signage violation, together with costs and reasonable attorney fees, as well as any appropriate injunctive or other equitable relief. The remedies provided in this section are not intended to be the exclusive remedies available to borrowers nor must borrowers exhaust any administrative remedies provided by contract or any other applicable law.
(d) Any predatory lending facility operated, conducted, or maintained in violation of this ordinance or any other federal or state law shall be, and hereby is, declared to be unlawful and a public nuisance. The Director may, in addition to or in lieu of any other remedies set forth in this ordinance, commence an action to enjoin, remove or abate such nuisance in the manner provided by law and shall take such other steps and apply to such court or courts as may have jurisdiction to grant such relief.

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

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.