

## COMMENT

### GET CASH UNTIL PAYDAY! THE PAYDAY-LOAN PROBLEM IN WISCONSIN

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\* J.D. expected, University of Wisconsin Law School, May 2007; B.A., Michigan State University, 2004. I would like to thank Steve Meili, Jean Ann Fox, Pete Koneazny, Carrie Templeton, Jon Hendrix, Jim Drogue, Lynn Drysdale, James Walrath, and Ron Elwood for their invaluable assistance. I could not have written this Comment without the patience and proofreading skills of my husband, Jason, and my family. Thank you for your support.

I write separately to add that which needs to be said: charging 300 percent interest for a short-term loan to those who can ill-afford it is ridiculous, unreasonable, and unconscionable. Wisconsin citizens deserve better.<sup>1</sup>

—Justice Louis B. Butler Jr., Wisconsin Supreme Court

## I. INTRODUCTION

Phyllis Blum lived in a suburb of Madison, Wisconsin and worked full-time for eight dollars an hour.<sup>2</sup> Just before Christmas in 1998, money became tight, and Blum could not afford to pay her rent.<sup>3</sup> She turned to a payday lender to help her pay her bills.<sup>4</sup> She wrote a postdated check for \$300 and received \$250 in cash.<sup>5</sup> “I thought, ‘Cool, problem solved,’” Blum said.<sup>6</sup> When the loan came due two weeks later, Blum did not have \$300 to repay the loan.<sup>7</sup> She decided to “roll over” the loan, paying \$50 cash to extend the loan for another two weeks.<sup>8</sup> Every two weeks, Blum paid a \$50 finance fee to extend the loan instead of paying it off.<sup>9</sup> She eventually borrowed \$100 from another payday lender to pay the first payday lender’s fees.<sup>10</sup> Two years later, Blum was still dealing with her two payday loans.<sup>11</sup> “What I thought were financial problems before were nothing compared to this,” she said.<sup>12</sup>

Unfortunately, Blum’s story is not an isolated incident.<sup>13</sup> An increasing number of consumers use payday loans to meet their financial

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1. Wis. Auto Title Loans, Inc. v. Jones, 2006 WI 53, ¶ 91, 290 Wis. 2d 514, 714 N.W.2d 155 (Butler, J., concurring).

2. Steven Walters, *Loans Smother One Woman, Give Another Room to Breathe*, MILWAUKEE J. SENTINEL, May 8, 2000, at 8A.

3. See Rick Barrett, *Interest of 500%*, WIS. ST. J., Dec. 12, 1999, at 1A.

4. See *id.*

5. *Id.*

6. *Id.*

7. See *id.*

8. See *id.*; Walters, *supra* note 2.

9. Barrett, *supra* note 3.

10. *Id.*

11. See Walters, *supra* note 2.

12. Barrett, *supra* note 3. In a 2000 interview, Blum noted that she was too poor to afford the \$200 bankruptcy filing fee. Walters, *supra* note 2.

13. For similar stories, see Ctr. for Responsible Lending, *The Victims of Payday Lending*, <http://www.responsiblelending.org/issues/payday/borrowers.html> (last visited Jan. 28, 2007).

needs.<sup>14</sup> In 2004, Wisconsin payday lenders made over 1.5 million payday loans worth over \$506 million.<sup>15</sup> Nationwide, 22,000 payday-loan locations extended \$40 billion in loans in 2005.<sup>16</sup> These loans cost consumers \$6 billion in fees each year.<sup>17</sup>

Payday loans are short-term loans in which a consumer receives cash in exchange for giving the lender a postdated check or electronic access to the consumer's bank account for the amount of the loan and a finance fee.<sup>18</sup> On the consumer's next payday—usually about two weeks later—the consumer can either pay back the full value of the loan and the finance fee or allow the payday lender to cash the check or debit their checking account.<sup>19</sup> If the consumer cannot pay back the loan, the consumer can roll over the loan by paying an additional finance fee to extend the loan's maturity date for another two weeks.<sup>20</sup>

Payday lending creates serious problems for consumers and the economy for several reasons. First, payday lenders charge high interest rates.<sup>21</sup> A typical finance charge for a payday loan is \$15 to \$30 per \$100 loaned, which, for a fourteen-day loan, equals an annual percentage rate (APR) of 390% to 780%.<sup>22</sup> One payday lender charged up to 7,300% APR.<sup>23</sup> Second, payday loans create long-term obligations for consumers. Consumers must pay back their entire loan and finance fee (or the face amount of their check) at one time.<sup>24</sup> Payday lenders do not

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14. See Pearl Chin, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723, 726-27; Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed'n of Am., Opening Remarks at the University of Wisconsin Payday Loan Forum (Sept. 22, 2005).

15. Carrie Templeton, Executive Assistant, Wis. Dep't of Fin. Insts., Address at the University of Wisconsin Payday Loan Forum (Sept. 22, 2005).

16. Paul Gores, *A Fast Cash Track to the Mainstream*, MILWAUKEE J. SENTINEL, Oct. 15, 2006, at 1D.

17. Consumer Fed'n of Am., Payday Loan Consumer Information, <http://www.paydayloaninfo.org/facts.cfm> (last visited Jan. 28, 2007).

18. See, e.g., Chin, *supra* note 14, at 724. Payday loans are also known as deferred-presentment transactions or cash advances. *Id.*

19. *Id.*

20. *Id.*

21. See, e.g., Charles A. Bruch, *Taking the Pay Out of Payday Loans: Putting an End to the Usurious and Unconscionable Interest Rates Charged by Payday Lenders*, 69 U. CIN. L. REV. 1257, 1279-80 (2001).

22. Jean Ann Fox, Opening Remarks at the University of Wisconsin Payday Loan Forum, *supra* note 14.

23. ELIZABETH RENUART & KATHLEEN E. KEEST, *THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES* § 7.5.5.3 n.467 (3d ed. 2005).

24. See Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 11 (2002).

assess consumers' ability to pay, and most consumers cannot afford to repay their entire loan at one time.<sup>25</sup> Accordingly, many consumers must roll over their loans, extending their debt.<sup>26</sup> Even worse, some consumers, like Blum, use a second payday lender to pay off their first loan.<sup>27</sup> Third, payday lenders engage in coercive collection practices.<sup>28</sup> Because payday lenders use personal checks as security for the loan, they can deposit the check and garner insufficient-funds fees when the loan comes due.<sup>29</sup> Further, some lenders threaten civil or criminal prosecution under bad-check laws, even if state law prohibits this practice.<sup>30</sup>

The payday-loan industry has expanded rapidly in Wisconsin.<sup>31</sup> In the past ten years, more than 400 loan companies have obtained licenses and opened payday-loan offices in the state.<sup>32</sup> In 2004, Wisconsin consumers paid over \$100 million in payday-loan fees.<sup>33</sup> Clearly, the payday-loan industry has had a huge economic impact on Wisconsin communities.<sup>34</sup> Despite this effect, Wisconsin is one of only two states

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A borrower cannot simply surrender his security and walk away; he remains legally obligated to pay the principal, and extension fees on the loan, and he must deal with the consequences if a lender tries to cash his usually worthless post-dated check or initiate his equally worthless [electronic-funds transfer].

Bruch, *supra* note 21, at 1273.

25. See Robert Mayer, *One Payday, Many Payday Loans: Short-Term Lending Abuse in Milwaukee County* 1 (Loyola Univ. Working Paper 2005), available at <http://www.luc.edu/depts/polisci/research/mayer21.pdf>; see also *infra* notes 72-76 and accompanying text.

26. Mayer, *supra* note 25, at 1.

27. See, e.g., Paul Chessin, *Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, 83 DENV. U. L. REV. 387, 411 (2005). Some scholars dub this phenomenon "borrowing from Peter to pay Paul." See *id.*; Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and Its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 601 (2000).

28. See Johnson, *supra* note 24, at 77-78.

29. Chin, *supra* note 14, at 732. These fees are in addition to any overdraft fees that the consumer's bank may charge. Telephone Interview with Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed'n of Am. (Oct. 26, 2006).

30. See Drysdale & Keest, *supra* note 27, at 610-11; Johnson, *supra* note 24, at 90. Wisconsin's worthless-check statute prohibits both civil and criminal prosecution for postdated checks. See WIS. STAT. §§ 943.24, .245 (2005-2006).

31. See WIS. DEP'T OF FIN. INSTS., REVIEW OF PAYDAY LENDING IN WISCONSIN 4 (2001) (noting that there were two payday lenders operating in 1996 and forty in 2001).

32. Telephone Interview with Carrie Templeton, Executive Assistant, Wis. Dep't of Fin. Insts. (Dec. 2, 2005).

33. Carrie Templeton, Address at the University of Wisconsin Payday Loan Forum, *supra* note 15.

34. Steven Walters, *Doyle Kills Payday Loan Plan*, MILWAUKEE J. SENTINEL, Apr. 6, 2004, at 1D (quoting Governor Jim Doyle); Marsha M. Mansfield, Op-Ed, *Bill*

that has not specifically addressed payday lending through legislation.<sup>35</sup> The prevalence of payday lending in Wisconsin, along with the lack of restrictions on its use, makes payday lending an important issue for Wisconsin consumers and policymakers.<sup>36</sup>

This Comment provides an overview of payday lending in Wisconsin and suggests how state policymakers can address the problems created by payday loans. Part II of this Comment discusses payday lending in the United States and applicable federal legislation. Next, Part III examines the payday-loan industry's expansion in Wisconsin. Part IV then summarizes how other states have confronted the payday-loan problem. Based on this discussion, Part V suggests three approaches for addressing payday lending in Wisconsin. First, this Part outlines the Wisconsin legislature's attempts to regulate payday lending and what elements should be included in a payday-loan statute. Second, it examines how local actions—such as zoning ordinances, litigation, and financial education—can address the most pervasive problems associated with payday lending. Third, it introduces some of the actions taken by banks and credit unions to compete with payday lenders. Finally, Part VI concludes that a multifaceted approach combining all of these measures will be necessary to successfully protect Wisconsin consumers from the problems associated with payday lending.

## II. PAYDAY LENDING IN THE UNITED STATES

Payday lending is part of the “alternative financial services” or “fringe-banking” sector in the United States.<sup>37</sup> In the 1980s, deregulation of the banking industry and elimination of interest-rate caps led many traditional loan providers to exit the risky small-loan industry and pursue more profitable higher-value loans.<sup>38</sup> The fringe-banking sector emerged to provide alternative banking services for consumers with low incomes or poor credit ratings.<sup>39</sup> Payday lending forms a key part of the fringe-

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*Won't Restrict Payday Loans*, WIS. ST. J., Mar. 26, 2004, at 10A (“The industry’s growth rate is not just an urban phenomenon: payday lenders exist in about 50 small towns and cities throughout Wisconsin.”).

35. See RENUART & KEEST, *supra* note 23, § 7.5.5.5 & n.482. The other state is New Mexico. *Id.*; see *infra* note 195.

36. For a more detailed description of the payday-loan industry in Wisconsin, see *infra* Part III.

37. Drysdale & Keest, *supra* note 27, at 591.

38. See Chin, *supra* note 14, at 727; Lisa Blaylock Moss, *Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 ALA. L. REV. 1725, 1732 (1999).

39. Drysdale & Keest, *supra* note 27, at 591.

banking sector by providing small loans to high-risk consumers who lack access to other forms of credit.<sup>40</sup>

#### A. *The Payday-Loan Industry*

Payday lending in the United States began in 1993.<sup>41</sup> As of 2005, there were between 23,000 and 25,000 payday-loan locations around the country that made over \$40 billion in loans and generated over \$6 billion in fees.<sup>42</sup> The payday-loan industry's growth is driven, in part, by its profitability.<sup>43</sup> The nation's largest monoline payday lender,<sup>44</sup> Advance America,<sup>45</sup> reported revenues of \$630 million in 2005, a 10.5% increase over the previous year.<sup>46</sup> The industry claims gross margins of 30% to 45% of annual revenue and a return on investment of 24%.<sup>47</sup> Thus, payday loans garner significant profits for lenders, making the industry attractive for new market entrants.<sup>48</sup>

The payday-loan industry and consumer advocates differ in their descriptions of payday-loan consumers. According to a 2001 industry-sponsored study, over half of payday-loan consumers have incomes ranging from \$25,000 to \$49,999.<sup>49</sup> The study reports that two-thirds of payday-loan consumers are under the age of forty-five, and the majority

40. Johnson, *supra* note 24, at 8.

41. Bruch, *supra* note 21, at 1270.

42. Consumer Fed'n of Am., *supra* note 17.

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

44. A monoline payday lender offers only payday loans. SHEILA BAIR, ANNIE E. CASEY FOUND., *LOW COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES* 6 n.1 (2005), [http://www.aecf.org/publications/data/payday\\_loans.pdf](http://www.aecf.org/publications/data/payday_loans.pdf) (citing STEPHENS, INC., *INDUSTRY REPORT: PAYDAY LOAN INDUSTRY* (2004)).

45. *Id.* at 18.

46. ADVANCE AM., CASH ADVANCE CTRS. INC., FORM 10-K (ANNUAL REPORT) 47 (Mar. 16, 2006).

47. Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 150 (2004). In comparison, banks make a return on investment of about 15%. Bertics, *supra* note 43, at 144-45.

48. See generally Bertics, *supra* note 43, at 141-42 (discussing the economic principles that spur new market entrants).

49. GREGORY ELLIEHAUSEN & EDWARD C. LAWRENCE, CREDIT RESEARCH CTR., *PAYDAY ADVANCE CREDIT IN AMERICA: AN ANALYSIS OF CONSUMER DEMAND* 28 (2001), <http://sbpm.gwu.edu/research/centers/fsrp/pdf/Mono35.pdf>. Only two-fifths of the general adult population lies within this income range. *Id.* Consumer advocates criticize the Elliehausen-Lawrence study because only 427 payday loan consumers, out of a sample size of 5,364 consumers, completed the survey. See, e.g., JOHN C. RUOFF, S.C. FAIR SHARE, *THE CREDIT RESEARCH CENTER STUDY OF PAYDAY LOAN CUSTOMERS 2* (on file with the Wisconsin Law Review).

are either married or living with a significant other.<sup>50</sup> The study also notes that most payday-loan consumers have children,<sup>51</sup> and over 40% own a home.<sup>52</sup> Further, the industry reports that 38% of payday-loan consumers have high-school diplomas, and 36% attended college.<sup>53</sup> Based on these and similar statistics, the industry claims that its consumers are middle-class Americans who need help to cover emergency expenses.<sup>54</sup>

In contrast, consumer advocates charge that payday lenders target low-income consumers on fixed incomes or welfare.<sup>55</sup> State surveys on payday lending found that payday-loan consumers have an average annual income of around \$25,000.<sup>56</sup> The majority of payday lenders operate in six states where consumers' median income falls below the national median.<sup>57</sup> Payday-loan consumers also tend to be young adults: 62% of payday-loan customers in Colorado were between the ages of twenty and twenty-nine.<sup>58</sup> In addition, payday lenders target racial minorities, women, and members of the military.<sup>59</sup> One payday lender's

50. ELLIEHAUSEN & LAWRENCE, *supra* note 49, at 29-30.

51. *See id.* at 31 tbl.5-4.

52. *See id.* at 42. Payday-loan consumers are less likely than the general adult population to own a home. *Id.*

53. *Id.* at 33 tbl.5-6.

54. *See* Bruch, *supra* note 21, at 1271.

55. *See, e.g.,* Johnson, *supra* note 24, at 100-01.

It'd be great if it was the middle class and it was just the plumber and all they need is \$200 this one time to get them by. But that's just not the reality. These are people who are really not making it. . . . They're not fixing a blown tire or a pipe—they're paying the rent.

Michael A. Stegman, *The Public Policy Challenges of Payday Lending*, 66 POPULAR GOV'T 16, 16 (2001) (quoting Rebekah O'Connell, Consumer Credit Counselor, Triangle Family Servs.).

56. *See* Johnson, *supra* note 24, at 99. These surveys included consumers from Illinois, Wisconsin, and California. *Id.*; *see also* Chessin, *supra* note 27, at 406 (reporting that the average payday-loan borrower in Colorado earned \$2,373 per month, or approximately \$28,476 per year).

57. Johnson, *supra* note 24, at 99. These six states are Kentucky, Missouri, Mississippi, Tennessee, South Carolina, and North Carolina. *Id.* at 99 n.525.

58. Chessin, *supra* note 27, at 405.

59. *See* Johnson, *supra* note 24, at 100-01. For information on the impact of payday loans on the military, see Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military Towns*, 66 OHIO ST. L.J. 653 (2005); U.S. DEP'T OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS (2006), [http://www.usa4militaryfamilies.dod.mil/dav/lsn/LSN/BINARY\\_RESOURCE/BINARY\\_CONTENT/2141721.pdf](http://www.usa4militaryfamilies.dod.mil/dav/lsn/LSN/BINARY_RESOURCE/BINARY_CONTENT/2141721.pdf). Graves and Peterson hypothesize that payday lenders target members of the military due to four factors: "(1) demographic characteristics which predispose military service members toward high-cost

business plan describes its customers as minorities; families with incomes of less than \$25,000; adults with a high-school education or less; adults under the age of fifty-nine; and females with dependent children.<sup>60</sup>

Consumers who use payday loans are also more likely to have had credit trouble.<sup>61</sup> They are three times more likely to have debt payment-to-income ratios of over 30%.<sup>62</sup> They are also four times more likely to have declared bankruptcy,<sup>63</sup> which impairs their ability to obtain traditional credit.<sup>64</sup> Almost three-fourths of payday-loan consumers were denied or given limited access to credit within the last five years.<sup>65</sup> These credit problems are one reason that consumers turn to payday lenders for small loans despite their high cost.<sup>66</sup>

### B. Problems with Payday Lending

Several aspects of payday lending make these loans troublesome for most consumers. First, payday loans carry triple-digit APRs that average 500%.<sup>67</sup> In comparison, organized-crime loan sharks usually charged only 260% APR.<sup>68</sup> The interest rates on payday loans exceed those charged by other lenders largely because of the loans' short term—usually two weeks.<sup>69</sup> Moreover, payday lenders do not assess consumers' ability to repay the loans.<sup>70</sup> The short term of the loans, coupled with

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indebtedness; (2) the form, amount, and distribution of military compensation; (3) dislocation faced by military service members and their families; and (4) military cultural considerations." Graves & Peterson, *supra*, at 675.

60. JEAN ANN FOX & EDMUND MIERZWINSKI, CONSUMER FED'N OF AM. & U.S. PUB. INTEREST RESEARCH GROUPS, RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 8 (2001), <http://www.consumerfed.org/pdfs/paydayreport.pdf>.

61. See ELLIEHAUSEN & LAWRENCE, *supra* note 49, at 45-46.

62. See *id.*

63. See *id.* at 46.

64. Johnson, *supra* note 24, at 102.

65. ELLIEHAUSEN & LAWRENCE, *supra* note 49, at 45.

66. See Johnson, *supra* note 24, at 102.

67. RENUART & KEEST, *supra* note 23, § 7.5.5.3.

68. Chin, *supra* note 14, at 729.

69. See Scott A. Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. BANKING INST. 339, 345 (2001). A longer term would reduce a loan's APR because the consumer would have to make fewer payments in a one-year period. See 12 C.F.R. § 226.22(a)(1) (2006) ("The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made.").

70. Mayer, *supra* note 25, at 1.

high interest rates, adversely affect consumers' ability to repay their loans on time.<sup>71</sup>

In 1999, Connecticut Senator Joseph Lieberman's staff prepared a budget analysis discussing consumers' ability to repay payday loans.<sup>72</sup> It concluded that, after deducting "essential" expenditures<sup>73</sup> from a two-week paycheck, consumers who earned \$25,000 or \$35,000 could not repay the average payday-loan debt.<sup>74</sup> At the \$25,000 level, consumers had a \$196 deficit, and at the \$35,000 level, consumers had a \$34 deficit.<sup>75</sup> The analysis showed that the high cost and short term of payday loans inhibit consumers' ability to pay back their loans on time, making them vulnerable to long-term financial hardships.<sup>76</sup>

Payday-loan industry advocates justify these high interest rates by claiming that they compensate lenders for the high risk of lending to subprime consumers<sup>77</sup>—those consumers with poor or nonexistent credit histories.<sup>78</sup> In addition, payday lending creates high transaction costs because lenders must personally interact with borrowers to create and collect on the loans.<sup>79</sup> The industry also argues that its rates are comparable to those charged for a bounced check.<sup>80</sup> Further, industry

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71. See Bruch, *supra* note 21, at 1280-81. The short term of these loans also hinders consumers' ability to recover from the financial emergency that forced them to seek out payday loans. *Id.* at 1281.

72. See Drysdale & Keest, *supra* note 27, at 632.

73. Essential expenditures include food, housing, utilities, transportation, and healthcare. *Id.*

74. See *id.* The study calculated the cost of fully paying off the principal and the finance fee of the loan and did not consider rollovers. See *id.*

75. *Id.*

76. See *id.* at 632-33

77. See Schaaf, *supra* note 69, at 349.

78. Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMP. L. REV. 1, 9-10 (2005) (defining subprime consumers in the mortgage market).

79. Barr, *supra* note 47, at 155. The expansion of the internet payday-loan industry weakens this justification. See JEAN ANN FOX & ANNA PETRINI, CONSUMER FED'N OF AM., INTERNET PAYDAY LENDING: HOW HIGH-PRICED LENDERS USE THE INTERNET TO MIRE BORROWERS IN DEBT AND EVADE STATE CONSUMER PROTECTIONS 5 (2004), [http://www.consumerfed.org/pdfs/Internet\\_Payday\\_Lending113004.PDF](http://www.consumerfed.org/pdfs/Internet_Payday_Lending113004.PDF) (giving an overview of Internet payday lending and the associated problems).

80. Barr, *supra* note 47, at 155. A Federal Reserve study found that bounced-check fees averaged \$20.73 in 2001. BD. OF GOVERNORS OF THE FED. RESERVE SYS., ANNUAL REPORT TO THE CONGRESS ON RETAIL FEES AND SERVICES OF DEPOSITORY INSTITUTIONS 5 tbl.4 (2002), <http://www.federalreserve.gov/boarddocs/rptcongress/2002fees.pdf>. These fees, however, may be less than the cost of some payday loans, and consumers have options other than bouncing a check. See Barr, *supra* note 47, at 155. "Furthermore, writing bad checks is illegal, and payday lenders should not justify their

advocates claim that the APR does not accurately describe the cost of payday loans because of the loans' short terms.<sup>81</sup> They analogize payday lending to taxi rides, reasoning that taxi fares are reasonable for short trips, but not for cross-country trips.<sup>82</sup> Similarly, payday-loan rates are reasonable for short-term financial problems, but not long-term financial difficulties.<sup>83</sup>

Consumer advocates counter that payday lenders make considerable profits, arguing that any increased risk does not justify the high cost of loans.<sup>84</sup> Moreover, the charge-off rate or loss experience of payday lenders is comparable to other forms of consumer lending.<sup>85</sup> Between 1996 and 2004, payday lenders charged off approximately 3.34% of their total loan volume.<sup>86</sup> In comparison, during the same time period, credit-card companies had a charge-off rate of 5.15%, and banks had a charge-off rate of 2.69% for all consumer loans.<sup>87</sup> Accordingly, "payday lenders have failed to adequately define a significant enough benefit to borrowers or a substantial enough risk to lenders to justify the exorbitant interest rates."<sup>88</sup>

Second, payday loans may trap consumers in a cycle of debt, or a "debt treadmill."<sup>89</sup> Consumers must pay off their entire payday-loan debt at one time because most lenders do not permit partial payments.<sup>90</sup> As demonstrated by the Lieberman study and other data on payday lending, most consumers cannot pay back their entire loan at one time and must roll over their loan.<sup>91</sup> Because consumers do not pay down the principal

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business by declaring it to be only a shade more respectable than criminal activity." Bruch, *supra* note 21, at 1279.

81. Barr, *supra* note 47, at 155.

82. Bruch, *supra* note 21, at 1280; Schaaf, *supra* note 69, at 349.

83. Bruch, *supra* note 21, at 1280. Consumer advocates claim that payday loans are not truly short-term financial instruments, and that they are more like locking the consumer in the taxi with the meter running. Telephone Interview with Jean Ann Fox, *supra* note 29; *see also infra* notes 89-96 and accompanying text.

84. *See* Drysdale & Keest, *supra* note 27, at 618 (citing research showing that payday lenders make profits as high as 30.37%).

85. *See* Chessin, *supra* note 27, at 408.

86. *Id.*

87. *Id.* (citing Fed. Reserve Bd., Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, <http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm> (seasonally adjusted)).

88. Bruch, *supra* note 21, at 1280.

89. *See id.* at 1273-74.

90. *See* Johnson, *supra* note 24, at 11.

91. *See id.* at 56, 59-60 (applying Lieberman's ability-to-repay study to payday-loan rollovers); Chessin, *supra* note 27, at 409-10 ("[M]any consumers who take out a payday loan are unable to pay off the loan in full on its due date."); Mayer, *supra* note 25, at 6. Consumers could also permit the lender to deposit their check, which could lead to

when rolling over a loan, they may ultimately pay more than the principal borrowed in the original loan.<sup>92</sup> “Over half of payday loan borrowers in North Carolina paid back more in fees than the amount they borrowed.”<sup>93</sup> Some consumers also use a second payday loan to pay off their first loan.<sup>94</sup> Both of these practices trap consumers in a debt treadmill; they force consumers to continue paying interest without ever repaying the original loan.<sup>95</sup> Thus, payday loans can become long-term financial burdens instead of quick fixes for short-term financial problems.<sup>96</sup>

Industry officials argue that rollovers rarely occur, with “only a tiny number of transactions resulting in more than one rollover, of the perhaps 10% of transactions that result in any rollovers at all.”<sup>97</sup> Data on consumers’ use of payday loans, however, demonstrates that rollovers and concurrent loans are prolific.<sup>98</sup> Several state government studies found that, on average, consumers rolled over their loans ten to twelve times per year.<sup>99</sup> A study by the Center for Responsible Lending discovered that lenders extend 91% of payday loans to borrowers who take out five or more loans per year,<sup>100</sup> and the average borrower

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insufficient-funds fees and other negative consequences. Jean Ann Fox, Opening Remarks at the University of Wisconsin Payday Loan Forum, *supra* note 14.

92. See Schaaf, *supra* note 69, at 346-47.

93. FOX & MIERZWINSKI, *supra* note 60, at 9. An extreme example involves a Kentucky consumer who paid \$1,000 in fees on a \$150 payday loan without ever reducing the principal. See Schaaf, *supra* note 69, 346-47.

94. See Chessin, *supra* note 27, at 411.

95. Johnson, *supra* note 24, at 57-58.

96. See *id.* at 58-59; Mayer, *supra* note 25, at 7. “Consumers playing catch-up with their expenses do not have the ability to overcome unexpected financial hardships because their budgets are usually limited. The high expense of a short-term loan depletes the consumer’s ability to catch-up, therefore making the consumer ‘captive’ to the lender.” Written Testimony of Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed’n of Am., Before the Forum on Payday Lending 8 (Dec. 15, 1999), <http://www.consumerfed.org/pdfs/pdLiebermanhearing.pdf>.

97. Drysdale & Keest, *supra* note 27, at 606 n.91 (quoting a payday-loan industry spokesperson testifying at the Lieberman forum) (emphasis omitted). Part of the reason for this assertion may be that the industry does not consider back-to-back loans (that is, when a consumer pays off one loan and immediately takes out another) as “rollovers.” Telephone Interview with Jean Ann Fox, *supra* note 29. See generally KEITH ERNST ET AL., CTR FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 3-4 (2004), <http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf>; Chessin, *supra* note 27, at 390-91; Drysdale & Keest, *supra* note 27, at 601.

98. See Johnson, *supra* note 24, at 57-60.

99. Chin, *supra* note 14, at 729.

100. ERNST ET AL., *supra* note 97, at 7.

receives between eight and thirteen loans each year.<sup>101</sup> Studies also show that payday lenders have an economic incentive to promote rollovers because a majority of payday lenders' revenue comes from repeat transactions.<sup>102</sup> Further, many payday lenders willingly permit consumers to take out multiple loans at one time.<sup>103</sup> One researcher obtained nine payday loans in three days and two more loans only two weeks later.<sup>104</sup>

Third, many payday lenders use coercive debt-collection practices.<sup>105</sup> Because payday lenders keep postdated checks or electronic access to a consumer's checking account as security, they are able to pursue collection options not available to other lenders.<sup>106</sup> Many payday lenders charge bounced-check fees if consumers do not repay their loans.<sup>107</sup> Consumers who bounce checks face difficulties obtaining future loan services<sup>108</sup> and may even lose their checking accounts.<sup>109</sup>

Some payday lenders also threaten or pursue civil and criminal remedies under bad-check statutes.<sup>110</sup> Payday lenders can use the threat of criminal sanctions "just as a loan shark might have used the threat of physical violence."<sup>111</sup> Payday lenders in one Texas precinct filed over 13,000 criminal bad-check charges against their customers in one year.<sup>112</sup> Lenders use this threat even in jurisdictions where officials refuse to prosecute payday-loan consumers.<sup>113</sup> In addition, under many civil bad-check statutes, plaintiffs can receive treble damages and attorneys' fees

101. *Id.* at 5 tbl.1.

102. *See* Chessin, *supra* note 27, at 411; Johnson, *supra* note 24, at 69-70. In Colorado, consumers who obtain twelve or more payday loans each year comprise only one-third of payday-loan consumers, but they generate two-thirds of lenders' annual loan volume. Chessin, *supra* note 27, at 411.

103. *See* Johnson, *supra* note 24, at 60-63.

104. *See id.* at 63. The lenders knew that the researcher had numerous payday loans outstanding, but they either accepted his excuses ("I lost money gambling last night") or refused to intervene ("[i]t's none of my business"). *See id.*

105. *See, e.g., id.* at 77-78 (discussing the inappropriate collection practices of some payday lenders).

106. Bertics, *supra* note 43, at 140.

107. FOX & MIERZWINSKI, *supra* note 60, at 15. These fees are in addition to those charged by the consumer's bank. Telephone Interview with Jean Ann Fox, *supra* note 29.

108. *See* Schaaf, *supra* note 69, at 347-48.

109. *See* Drysdale & Keest, *supra* note 27, at 606 n.95.

110. *See* Bertics, *supra* note 43, at 140.

111. Moss, *supra* note 38, at 1731 (quoting John Hendren, *More States Allow Triple-Digit Loan Rates*, TUSCALOOSA NEWS, Jan. 10, 1999, at 6B).

112. Drysdale & Keest, *supra* note 27, at 610.

113. Johnson, *supra* note 24, at 87.

in addition to regular bounced-check fees.<sup>114</sup> Studies have found that many lenders' lawsuits result in default judgments for the lenders and garnishment of the consumers' wages.<sup>115</sup>

States' efforts to exempt payday-loan consumers from liability under bad-check statutes have not stopped payday lenders from using these statutes to collect on their loans.<sup>116</sup> Most bad-check statutes do not apply to payday-loan consumers because they do not intend to defraud the lender and because the lenders know that the check is worthless when they accept it.<sup>117</sup> Wisconsin's statute explicitly exempts postdated checks, like those used in payday loans,<sup>118</sup> and some state statutes even explicitly exclude payday loans.<sup>119</sup> Despite these limitations, however, lenders still threaten and pursue treble damages and criminal prosecution.<sup>120</sup> Threatening or attempting to collect on a debt through illegal means violates the Fair Debt Collection Practices Act.<sup>121</sup> Unfortunately, most consumers do not realize that lenders cannot collect in this way, so threatening prosecution or a lawsuit can be a powerful coercive device.<sup>122</sup>

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114. See Drysdale & Keest, *supra* note 27, at 611-12; Johnson, *supra* note 24, at 78-79. In Illinois, one payday lender filed a lawsuit seeking \$1,260 for a \$240 loan (\$720 in treble damages and \$300 in attorney's fees). *Id.* at 78.

115. See, e.g., WOODSTOCK INST., HUNTING DOWN THE PAYDAY LOAN CONSUMER: THE DEBT COLLECTION PRACTICES OF TWO PAYDAY LOAN COMPANIES 9-10 (2006), [http://www.woodstockinst.org/component/option,com\\_docman/Itemid,1/task,doc\\_download/gid,639/](http://www.woodstockinst.org/component/option,com_docman/Itemid,1/task,doc_download/gid,639/); Johnson, *supra* note 24, at 79.

116. See, e.g., Johnson, *supra* note 24, at 80-83 (discussing how payday lenders in Ohio continued to collect treble damages for bad checks even after the Ohio legislature changed the law to bar that practice).

117. See Drysdale & Keest, *supra* note 27, at 611; IND. DEP'T OF FIN. INSTS., DEPARTMENT OF FINANCIAL INSTITUTIONS POLICY STATEMENT ON PAYDAY LENDING AND CHECK DECEPTION & CHECK FRAUD 2 (2005), [http://www.in.gov/dfi/Documents/Policy\\_Statement.pdf](http://www.in.gov/dfi/Documents/Policy_Statement.pdf); Johnson, *supra* note 24, at 90; see also *Turner v. E-Z Check Cashing of Cookeville, Tenn., Inc.*, 35 F. Supp. 2d 1042, 1051 (M.D. Tenn. 1999); *Jones v. Kunin*, No. 99-818-GPM, 2000 U.S. Dist. LEXIS 6380, at \*3 (S.D. Ill. May 1, 2000); *Hartke v. Ill. Payday Loans, Inc.*, No. 99-3119, 1999 U.S. Dist. LEXIS 14937 (C.D. Ill. Sept. 13, 1999).

118. WIS. STAT. § 943.24(4) (2005-2006).

119. See, e.g., OHIO REV. CODE ANN. § 1315.41(D) (LexisNexis 2002).

120. Johnson, *supra* note 24, at 92-93 (discussing a criminal prosecution of a payday-loan consumer that occurred even though Ohio law does not permit prosecution of payday-loan consumers under its bad-check statute).

121. See 15 U.S.C. § 1692e (2000).

122. See Drysdale & Keest, *supra* note 27, at 611; Johnson, *supra* note 24, at 96.

As long as payday lenders have the ability to use the criminal justice system as a collection agency, they possess a strong economic incentive to threaten customers with criminal prosecution. Payday loan customers will do

Payday loans create problems for consumers because they charge high interest rates, encourage chronic borrowing and rollovers, and facilitate coercive debt-collection practices. Further, payday lenders do not inquire into consumers' ability to repay. For many consumers already described as "desperate persons in dire need,"<sup>123</sup> a payday loan can make a bad situation worse.<sup>124</sup>

### C. Federal Regulation of Payday Loans

Federal laws and regulations on consumer credit transactions apply to payday lending,<sup>125</sup> but they do little to curb payday-loan abuses because they do not address the particular features that make payday lending harmful.<sup>126</sup> The key federal regulations are the Truth in Lending Act (TILA)<sup>127</sup> and the Racketeering Influenced and Corrupt Organizations Act (RICO),<sup>128</sup> but neither law provides substantive limits on payday lenders.<sup>129</sup> In addition, recent attempts to create federal baseline regulations for all payday lenders have failed to garner sufficient support.<sup>130</sup> Therefore, while federal legislation provides limited regulation of payday lenders, states must still act to provide substantive regulations of the payday-loan industry.<sup>131</sup>

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whatever it takes to keep from going to jail; thus, payday lenders are assured of getting paid as long as consumers fear imprisonment.

*Id.*

123. Bruch, *supra* note 21, at 1271-72 (quoting *Gutierrez v. Devon Fin. Servs., Inc.*, No. 99-C-2647, 1999 U.S. Dist. LEXIS 19738, at \*2 (N.D. Ill. Sept. 29, 1999)).

124. Of course, not all consumers become overwhelmed with payday-loan debt, and some consumers do use payday loans only for financial emergencies. *See* Anita Weier, *Payday Loans Under Fire*, CAP. TIMES (Madison, Wis.), Oct. 3, 2001, at 3A.

125. Johnson, *supra* note 24, at 13.

126. Telephone Interview with Jean Ann Fox, *supra* note 29.

127. 15 U.S.C. §§ 1601-67.

128. 18 U.S.C. §§ 1961-68 (2000).

129. *See* Chin, *supra* note 14, at 740-43 (discussing how payday lenders operate in a free market despite the current regulations); Johnson, *supra* note 24, at 116-22 (discussing the limitations of current laws on payday lending).

130. *See, e.g.*, Bruch, *supra* note 21, at 1285-86 (discussing the Payday Borrower Protection Act of 1999, H.R. 1684, 106th Cong. (1999)); Johnson, *supra* note 24, at 134-39 (discussing the Payday Borrower Protection Act, H.R. 1319, 107th Cong. (2001)). The exception to this statement is the Talent-Nelson Amendment to the John Warner National Defense Authorization Act for Fiscal Year 2007, which provides substantive limits on payday loans offered to members of the military. Pub. L. No. 109-364, sec. 670, 120 Stat. 2083, 2266 (2006) (to be codified in 10 U.S.C. § 987); *see infra* notes 152-57 and accompanying text.

131. *See infra* Part IV.

TILA is the primary federal regulation that affects payday lenders.<sup>132</sup> Congress adopted TILA in 1968 to increase consumers' awareness of the cost of credit.<sup>133</sup> TILA requires lenders that issue "consumer credit"<sup>134</sup> to provide disclosure statements that include the amount financed, the total finance charge, and the APR.<sup>135</sup> While some payday lenders originally claimed to be exempt from TILA requirements,<sup>136</sup> courts<sup>137</sup> and the Federal Reserve Board<sup>138</sup> ruled that payday loans constitute "consumer credit."

TILA has had limited effectiveness in protecting consumers from the problems associated with payday lending.<sup>139</sup> Surveys show that many lenders violate TILA either by failing to make the proper disclosures,<sup>140</sup> or by delaying them until immediately before or after consummation of the loan transaction.<sup>141</sup> Even if lenders make the required disclosures,

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132. See Johnson, *supra* note 24, at 13; see also Thomas A. Wilson, *The Availability of Statutory Damages Under TILA to Remedy the Sharp Practice of Payday Lenders*, 7 N.C. BANKING INST. 339, 343-45 (2003) (discussing the application of TILA to payday lenders).

133. See Pub. L. No. 90-321, § 102, 82 Stat. 146, 146 (1968) (codified as amended at 15 U.S.C. § 1601(a) (2000)). Congress also granted the Federal Reserve Board the authority to write regulations to implement TILA. See 15 U.S.C. § 1604(a). The Board issued Regulation Z to clarify lenders' TILA requirements. See 12 C.F.R. §§ 226.1-33 (2006).

134. The Code of Federal Regulations defines "consumer credit" as "credit offered or extended to a consumer primarily for personal, family, or household purposes." 12 C.F.R. § 226.2(a)(12).

135. *Id.* § 226.4.

136. Lenders argued that they provided check-cashing services, not "consumer credit." See, e.g., Johnson, *supra* note 24, at 16; Wilson, *supra* note 132, at 343; see also *Hamilton v. York*, 987 F. Supp. 953, 956 (E.D. Ky. 1997).

137. See, e.g., *Hamilton*, 987 F. Supp. at 956; *Turner v. E-Z Check Cashing of Cookeville, Tenn., Inc.*, 35 F. Supp. 2d 1042, 1048 (M.D. Tenn. 1999); *Cashback Catalog Sales, Inc. v. Price*, 102 F. Supp. 2d 1375, 1382 (S.D. Ga. 2000).

138. See *Truth in Lending*, 65 Fed. Reg. 17,129, 17,129 (Mar. 31, 2000).

139. See, e.g., Johnson, *supra* note 24, at 18, 37.

140. See, e.g., FOX & MIERZWINSKI, *supra* note 60, at 13 ("Of the 235 stores surveyed, only 32% of payday lenders disclosed even a nominally accurate APR on charts or brochures in their stores."); Johnson, *supra* note 24, at 37-49 (discussing TILA violations by Ohio lenders in a recent survey). Some lenders purposefully avoid TILA disclosure requirements by disguising the nature of the transactions through alternative lending schemes, such as leasing appliances. See Johnson, *supra* note 24, at 18-25.

141. See Diane Hellwig, *Exposing the Loansharks in Sheep's Clothing: Why Re-Regulating the Consumer Credit Market Makes Economic Sense*, 80 NOTRE DAME L. REV. 1567, 1590 (2005); Johnson, *supra* note 24, at 44-45. TILA requires lenders to make clear and conspicuous loan disclosures on a written form before the lender extends the loan. See 12 C.F.R. § 226.17(a)-(b) (2006). In both the Fourth and the Seventh Circuits, however, lenders do not have to make these until immediately before consummation of the loan. See *Gavin v. Koons Buick Pontiac GMC, Inc.*, 28 F. App'x

consumers may not read and understand them, and they may not be enough to motivate consumers to spend the resources needed to seek other sources of credit.<sup>142</sup> Moreover, many consumers base their borrowing decisions on the monthly payment instead of on the APR or other long-term measures of the cost of credit, making TILA disclosures “interesting but irrelevant” to their behavior.<sup>143</sup>

Further, consumers may encounter difficulties vindicating their rights under TILA.<sup>144</sup> While consumers can collect both statutory and actual damages for TILA violations,<sup>145</sup> these damages may not be significant enough to justify the costs of bringing a lawsuit.<sup>146</sup> Moreover, most, if not all, payday-loan contracts contain arbitration clauses that may limit consumers’ ability to seek redress.<sup>147</sup>

Another federal law that affects the payday-loan industry is RICO, which Congress passed in 1970 to eradicate organized crime.<sup>148</sup> RICO prohibits lenders from extending credit at a usurious rate, or twice the legal interest rate.<sup>149</sup> In states with usury laws, RICO section 1962(c) may provide consumers with a private cause of action for treble damages against payday lenders that violate usury limits.<sup>150</sup> In addition, the

220, 222 (4th Cir. 2002) (unpublished opinion); Spearman v. Tom Wood Pontiac-GMC, Inc., 312 F.3d 848, 851 (7th Cir. 2002).

142. Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL’Y 199, 229-34 (2005); Hellwig, *supra* note 141, at 1590-93; Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 751-54 (2006).

143. See Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided “Reform” of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1539 (2006). See generally Willis, *supra* note 142 (discussing how predatory lenders take advantage of the heuristics, biases, and coping mechanisms that borrowers use in their loan decisionmaking).

144. See, e.g., Johnson, *supra* note 24, at 48-49.

145. See 15 U.S.C. § 1640(a)(1)-(2) (2000). Circuits split on whether plaintiffs can receive statutory damages for all TILA disclosure violations. See generally Wilson, *supra* note 132, at 347-49.

146. See TILA, Pub. L. No. 90-321, § 130(a)(1), 82 Stat. 146, 157 (1968) (codified as amended at 15 U.S.C. § 1640(a)(2)(A)(i)) (limiting individual damages to \$1,000 per plaintiff for disclosure violations); Richard B. Cappalli, *Arbitration of Consumer Claims: The Sad Case of Two-Time Victim Terry Johnson or Where Have You Gone Learned Hand?*, 10 B.U. PUB. INT. L.J. 366, 404-05 (2001) (describing how, in the absence of a class action, one TILA plaintiff could only collect between \$100 and \$1,000 in damages).

147. See *infra* notes 425-30 and accompanying text.

148. Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922, 923 (codified as amended at 18 U.S.C. §§ 1961-68 (2000)).

149. 18 U.S.C. § 1961(6) (2000).

150. See Drysdale & Keest, *supra* note 27, at 642 & n.326.

government can bring criminal charges against payday lenders for RICO violations.<sup>151</sup>

Recognizing the problems associated with payday lending, members of Congress have attempted to pass legislation specifically limiting payday lending.<sup>152</sup> Scholars support federal legislation to provide a baseline set of consumer protections in lieu of a patchwork of state regulations.<sup>153</sup> In October 2006, Congress enacted the Talent-Nelson Amendment to the John Warner National Defense Authorization Act for Fiscal Year 2007 to protect active members of the military from payday lenders and other predatory forms of credit.<sup>154</sup> Congress passed the amendment after the Department of Defense released a report outlining the negative impact of predatory lending on members of the military.<sup>155</sup> The Talent-Nelson Amendment bars creditors—including payday lenders—from charging an interest rate that exceeds 36% APR.<sup>156</sup> In addition, the amendment bars rollovers, mandatory arbitration agreements, and credit transactions in which the creditor gains access to a consumers' bank account through a check or electronic access.<sup>157</sup>

Pending legislation attempts to extend some of the protections in the Talent-Nelson Amendment to all consumers. One pending bill includes a wide variety of consumer protections, including provisions that cap interest rates at 36% APR, prohibit rollovers, mandate a thirty-day "cooling off" period between loans, and limit the maximum amount of the loan to \$300.<sup>158</sup> Similar legislation has previously failed to pass,<sup>159</sup> and the prospect of the pending bills passing is unclear.

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151. See 18 U.S.C. § 1963. State RICO statutes also permit criminal penalties. See, e.g., WIS. STAT. §§ 946.83-.84 (2005-2006).

152. See, e.g., Payday Borrower Protection Act of 2005, H.R. 1660, 109th Cong. (2005); Predatory Payday Loan Prohibition Act of 2005, S. 1878, 109th Cong. (2005); Borrower's Bill of Rights Act, H.R. 1643, 109th Cong. (2005).

153. See, e.g., Chin, *supra* note 14, at 749; Johnson, *supra* note 24, at 133 ("Congress should take on payday lending because consumers will continue to be subject to many abuses perpetrated by the industry because state laws cannot adequately protect them."). This Comment suggests that, in lieu of federal legislation, Wisconsin should use a combination of state legislation, local action, and increased market competition to combat payday lending. See *infra* Part IV.D.

154. Pub. L. No. 109-364, sec. 670, 120 Stat. 2083, 2266 (2006) (to be codified in 10 U.S.C. § 987); see also Press Release, Ctr. for Responsible Lending, Passage of SA 4331: Consumer Credit for Service Members, <http://www.responsiblelending.org/policy/congress/page.jsp?itemID=29895875> (last visited Jan. 28, 2007).

155. See generally U.S. DEP'T OF DEFENSE, *supra* note 59.

156. Pub. L. No. 109-364, sec. 670, § 987(b), 120 Stat. at 2266.

157. See *id.* § 987(e).

158. See Payday Borrower Protection Act of 2005, H.R. 1660, 109th Cong. (2005). Another bill would bar federal institutions from making payday loans, and would

## III. THE PAYDAY-LOAN PROBLEM IN WISCONSIN

The payday-loan industry entered Wisconsin in 1993.<sup>160</sup> By the end of 1995, two licensed payday lenders operated seventeen offices in the state.<sup>161</sup> As of January 2007, 472 payday-loan locations held licenses from Wisconsin's Department of Financial Institutions (DFI).<sup>162</sup> Wisconsin payday lenders charge triple-digit interest rates: in 2001, the average APR for a payday loan was 542.2%.<sup>163</sup> In 2004, Wisconsin payday lenders made 1.6 million loans worth over \$500 million.<sup>164</sup> Because out-of-state investors own most Wisconsin payday lenders, 80% of this loan revenue left the state.<sup>165</sup> Due to the popularity and profitability of payday lending, it is an important issue for Wisconsin consumers and its economy.<sup>166</sup>

According to a 2001 DFI survey, the typical payday-loan consumer in Wisconsin is a thirty-nine-year-old female with an annual net income of \$18,675.<sup>167</sup> More than half of Wisconsin payday-loan consumers live in African-American neighborhoods,<sup>168</sup> and most rent their homes.<sup>169</sup> Out of 321 surveyed payday-loan consumers, twelve took out at least

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prohibit lenders from making loans based on negotiable instruments from federally insured institutions. Federal Payday Loan Consumer Protection Amendments of 2006, H.R. 5350, 109th Cong. (2006).

159. See Bruch, *supra* note 21, at 1285 (discussing the Payday Borrower Protection Act of 1999, H.R. 1684, 106th Cong. (1999)); Johnson, *supra* note 24, at 134-39 (discussing the Payday Borrower Protection Act of 2001, H.R. 1319, 107th Cong. (2001)).

160. WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 4.

161. *Id.*

162. WIS. DEP'T OF FIN. INSTS., Licensed Financial Services Licensee Lists, [http://www.wdfi.org/fi/lfs/licensee\\_lists/](http://www.wdfi.org/fi/lfs/licensee_lists/) (under "Loan Companies," select "Pay Day Lenders – Loan Companies"; then follow "view list" hyperlink); see also E-mail from Carrie Templeton, Executive Assistant, Wis. Dep't of Fin. Insts., to author (Sept. 25, 2006) (on file with the Wisconsin Law Review).

163. WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 6. In 2001, finance charges averaged \$49.73, and the average loan amount was \$246.19. *Id.*

164. Carrie Templeton, Address at the University of Wisconsin Payday Loan Forum, *supra* note 15.

165. *Id.*

166. See, e.g., Walters, *supra* note 34. According to Wisconsin Governor Jim Doyle, "This industry has a huge economic impact on our communities, and we need to seriously address this issue." *Id.*

167. WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 5.

168. See Mayer, *supra* note 25, at 7 tbl.1. For more information on race issues in predatory lending, see Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 AM. U. L. REV. 1217 (2004).

169. See WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 5.

twenty-five loans in a one-year period.<sup>170</sup> Over 70% of Wisconsin payday-loan consumers took out more than six loans during 2000, and almost 30% borrowed from a payday lender an average of at least once a month.<sup>171</sup> Fifty-three percent of Wisconsin payday-loan consumers roll over their loans.<sup>172</sup> Of these loans, 38% are rolled over more than three consecutive times.<sup>173</sup> These statistics suggest that Wisconsin consumers use payday loans as a continuous financial tool instead of as a short-term fix for financial emergencies.

Wisconsin consumer bankruptcy filings establish that bankruptcy petitioners with payday loans go bankrupt sooner than other debtors, and with less debt in relation to their income.<sup>174</sup> According to a recent survey of Milwaukee County bankruptcy petitions by Professor Robert Mayer, about 15% of bankruptcy petitioners listed a payday lender as a creditor.<sup>175</sup> Seventy percent of these petitioners owed money to more than one payday lender, and nearly 30% owed money on four or more payday loans.<sup>176</sup> The survey also showed that petitioners with payday loans typically owed all of their next paycheck to payday lenders.<sup>177</sup> Petitioners with multiple loans typically owed more than their next paycheck to payday lenders, "making roll-overs inevitable."<sup>178</sup> Mayer claims that the results of his study show that Wisconsin payday lenders exploit vulnerable consumers.<sup>179</sup>

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170. *Id.* at 6. These numbers include loans that consumers rolled over. *Id.* However, DFI's study did not analyze whether consumers had loans outstanding with more than one payday lender. See JOHN P. CASKEY, *THE ECONOMICS OF PAYDAY LENDING* 36 (2002).

171. See WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 6-7. The DFI surveyed 321 persons, and ninety-four of them, or 29%, had more than fifteen loans per year. See *id.*

172. *Id.* at 7. Critics claim that DFI's rollover statistics understate the problem because they do not include consumers who defaulted on their loans. See, e.g., FOX & MIERZWINSKI, *supra* note 60, at 8. Further, this number does not include borrowers who pay off a loan and immediately take out a new loan. See CASKEY, *supra* note 170, at 36.

173. WIS. DEP'T OF FIN. INSTS., *supra* note 31, at 8.

174. Robert Mayer, *Payday Lending and Personal Bankruptcy*, 50 CONSUMER INTS. ANN. 76, 81 (2004) (reporting the results of a payday-lending study that used data from Wisconsin, Illinois, and New Mexico).

175. Mayer, *supra* note 25, at 5.

176. *Id.*

177. *Id.* at 6.

178. See *id.* Just rolling over the loans would require 30% of the average petitioner's paycheck. *Id.*

179. See *id.* at 7. See generally Robert Mayer, *Payday Loans and Exploitation*, 17 PUB. AFF. Q. 197, 212-13 (2003) (concluding, based on philosophical explanations of exploitation, that payday loans are exploitative because lenders take advantage of desperate borrowers).

Wisconsin payday lenders also constitute a significant portion of small claims court filings.<sup>180</sup> According to a student survey of small claims court records, from January 2005 through December 2005, payday lenders filed 13.5% of all small claims actions for money judgments in Dane County, Wisconsin.<sup>181</sup> This outnumbers the claims filed by financial institutions (about 9%) and debt collectors (about 7%).<sup>182</sup> One Madison, Wisconsin payday lender filed 463 claims.<sup>183</sup> During the one-year time period examined, Dane County courts awarded payday lenders over \$600,000 in damages.<sup>184</sup>

Currently, Wisconsin law imposes few substantive limits on payday lenders.<sup>185</sup> Payday lenders are subject to licensing, examination, and reporting requirements under Wisconsin's lending statute.<sup>186</sup> For example, payday lenders must have a net worth of at least \$50,000.<sup>187</sup> DFI also examines payday lenders to ascertain if they have violated licensing rules and to review disclosures, finance charges, late charges, refunds, and procedures for nonpayment.<sup>188</sup> Unfortunately, DFI employs only three examiners to investigate all of Wisconsin's payday-loan locations.<sup>189</sup> The lack of funding and personnel for the enforcement of the few payday-loan regulations that do exist permits lenders to operate largely unregulated.

Wisconsin's payday-loan industry is large, and it continues to grow.<sup>190</sup> Along with the growth of the industry come problems for consumers, as demonstrated by DFI's 2001 study. Based on these findings, Wisconsin legislators, regulators, and consumers should take steps to combat the problems created by payday lending and to ensure

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180. See JON HENDRIX & KELLY NOYES, PAYDAY LENDING IN MADISON, WISCONSIN 9 (2006) (on file with the Wisconsin Law Review) (reporting the result of a student survey of payday lenders in Madison, Wisconsin).

181. *Id.* at 9. Hospitals and medical clinics filed the largest percentage of small claims court money judgments (18%). *Id.*

182. *Id.*

183. *Id.* at 11.

184. *Id.* at 16, app. C.

185. See RENUART & KEEST, *supra* note 23, § 7.5.5.5 & n.482. For example, payday lenders must provide consumers with written agreements and repay unearned interest if consumers repay their loans before their maturity date. Carrie Templeton, Address at the University of Wisconsin Payday Loan Forum, *supra* note 15.

186. See WIS. STAT. § 138.09 (2005-2006).

187. WIS. DEP'T OF FIN. INSTS., *supra* note 32, at 3.

188. *Id.*

189. Carrie Templeton, Address at the University of Wisconsin Payday Loan Forum, *supra* note 15.

190. *Id.*

that Wisconsin consumers do not become overwhelmed with payday-loan debt.

#### IV. OTHER STATES' REGULATION OF PAYDAY LOANS

All states have experienced problems with the payday-loan industry, and most have developed ways to deal with these problems.<sup>191</sup> Scholars classify states' regulations into three categories.<sup>192</sup> Category one is comprised of twelve states, the Virgin Islands, and Puerto Rico,<sup>193</sup> all of which have usury statutes that effectively ban payday lending by limiting maximum APRs, most commonly to 36%.<sup>194</sup> Category two consists of two states—New Mexico and Wisconsin—that only require payday lenders to comply with a general small-loan law.<sup>195</sup> In category three, thirty-six states and the District of Columbia specifically authorize payday lending through enabling legislation.<sup>196</sup> These laws generally

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191. See FOX & MIERZWINSKI, *supra* note 60, at 8-10 & apps. A-B.

192. See, e.g., RENUART & KEEST, *supra* note 23, § 7.5.5.5.

193. *Id.* The twelve states are Arkansas, Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont, and West Virginia. *Id.* § 7.5.5.5 & n.479. North Carolina's payday-loan law expired in 2001, and payday loans now violate the state's usury limit. *Id.* For a list of payday-loan laws by state, see *id.* app. A (2005 & Supp. 2006). See generally Consumer Fed'n of Am., PayDay Loan Consumer Information, <http://www.paydayloaninfo.org/lstatus.cfm> (last visited Jan. 28, 2007) (providing the current legal status of payday lending by state).

194. See RENUART & KEEST, *supra* note 23, § 7.5.5.5. Payday lenders formerly offered loans in some of these states, despite the usury limits, through a phenomenon known as charter renting or rent-a-bank. See *infra* notes 279-90 and accompanying text. Therefore, most of these states have laws that create other requirements for payday loans, including maximum loan amounts, minimum loan terms, and licensing requirements. RENUART & KEEST, *supra* note 23, § 7.5.5.5.

195. See RENUART & KEEST, *supra* note 23, § 7.5.5.5 n.482 & app. A (2005 & Supp. 2006). Wisconsin's small-loan law includes, for example, prepayment requirements and regulations on loan installment payments. See WIS. STAT. § 138.05 (2005-2006). Former New Mexico Attorney General Patricia Madrid created payday-lending regulations to enforce the New Mexico Unfair Practices Act, N.M. STAT. § 57-12-1 to -24 (LexisNexis 2006). See N.M. ADMIN. CODE § 12.2.10.3 (2006) (repealed 2006), [http://www.ago.state.nm.us/divs/cons/small\\_loan\\_ruels\\_regs/small\\_loan\\_regs.pdf](http://www.ago.state.nm.us/divs/cons/small_loan_ruels_regs/small_loan_regs.pdf). Unfortunately, a New Mexico court struck down the regulations as exceeding the Attorney General's legal authority. See Jeff Jones, *Payday Loan Limits Tossed*, ALBUQUERQUE J., Aug. 31, 2006, at A1. The Attorney General plans to appeal. *Id.*

196. RENUART & KEEST, *supra* note 23, § 7.5.5.5. The states are Alabama, Alaska, Arizona, California, Colorado, Delaware, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia,

include limits on payday lenders, such as limits on loan terms or amounts, fees, and rollovers.<sup>197</sup> Despite these limits, some lenders have found ways to evade the regulations in many category-three states.<sup>198</sup>

This Part will briefly discuss the payday-loan laws of Minnesota, Florida, and Georgia. Each state provides a different level of consumer protection. These states' statutes are representative of the approaches taken by other states.<sup>199</sup> The first two states, Minnesota and Florida, are category-three states that specifically regulate payday lending. Minnesota's statute has some substantive restrictions,<sup>200</sup> but they have proven to be ineffectual in practice.<sup>201</sup> Florida's statute provides some stronger protections, but consumer advocates argue that it does not sufficiently address all of the problems associated with payday lending.<sup>202</sup> The third state, Georgia, is a category-one state that prohibits payday lending,<sup>203</sup> representing the strongest protection that a state can offer. By examining the issues raised by these statutes, Wisconsin policymakers can predict and avoid the difficulties associated with regulating payday lending.

#### A. *Minnesota*

Minnesota's consumer small-loan statute contains several key substantive provisions that regulate payday lenders. First, the statute limits payday loans to \$350.<sup>204</sup> Second, it limits finance charges based on the amount of the loan.<sup>205</sup> Even with these restrictions, payday loans in

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Washington, and Wyoming. *Id.* § 7.5.5.5 & n.482; *see also id.* app. A (2005 & Supp. 2006); Consumer Fed'n of Am., *supra* note 193.

197. *See* RENUART & KEEST, *supra* note 23, § 7.5.5.5.

198. *See id.* The payday-loan industry supported many of these laws. *See id.*

199. For example, Florida's statute is similar to those in Oklahoma and Indiana, *compare* FLA. STAT. ANN. §§ 560.401-.408 (West 2002 & Supp. 2006), *with* OKLA. STAT. ANN. tit. 59, §§ 3101-19 (West Supp. 2007), *and* IND. CODE ANN. §§ 24-4.5-7-101 to -414 (LexisNexis 2006), while Minnesota's law is similar to that of Wyoming. *Compare* MINN. STAT. ANN. § 47.60 (West Supp. 2006), *with* WYO. STAT. ANN. §§ 40-14-362 to -364 (2005).

200. *See* MINN. STAT. ANN. § 47.60.

201. Telephone Interview with Ron Elwood, Att'y, Legal Servs. Advocacy Project (Oct. 19, 2005).

202. Telephone Interview with Lynn Drysdale, Consumer Law Att'y, Jacksonville Area Legal Aid (Oct. 27, 2005).

203. *See* GA. CODE ANN. § 16-17-1(e) (Supp. 2006).

204. MINN. STAT. ANN. § 47.60(1)(a).

205. *See id.* § 47.60(2)(a). For example, for loans greater than \$250 but less than \$350, lenders can charge "six percent of the loan proceeds with a minimum of \$17.50 plus a \$5 administration fee." *Id.* § 47.60(2)(a)(4).

Minnesota can have triple-digit APRs.<sup>206</sup> Third, the statute creates a maximum term of thirty calendar days.<sup>207</sup> Fourth, it prohibits rollovers and concurrent loans in excess of \$350.<sup>208</sup> Fifth, the statute creates licensing and disclosure requirements.<sup>209</sup> The Commissioner of Commerce enforces the law by investigating consumer complaints concerning payday lenders.<sup>210</sup> Lenders who violate the law are guilty of a misdemeanor.<sup>211</sup>

Despite the apparent strength of these substantive provisions, Minnesota's statute has done little to help consumers in practice.<sup>212</sup> Its greatest weakness is its enforcement mechanism,<sup>213</sup> which is based on consumer complaints.<sup>214</sup> A representative from the Minnesota Department of Banking admitted that the Department receives "very few" complaints against payday lenders, and it does not audit lenders unless there has been a complaint.<sup>215</sup> Consumers rarely complain about payday lending because "[t]hey think it's their fault that they're in debt over their heads and can't get out, not that some law they never heard of

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206. See Ron Nixon et al., *Borrowing Trouble*, STAR TRIB. (Minneapolis), Aug. 15, 2004, at 1A (noting that one Minnesota payday-loan consumer paid an APR of 469%, which Minnesota law permitted).

207. MINN. STAT. ANN. § 47.60(2)(b).

208. The language of the statute is as follows:

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

*Id.* § 47.60(2)(f).

209. See *id.* § 47.60(3)-(4).

210. See *id.* § 47.60(5).

211. See *id.* § 47.60(6) (incorporating the penalty provisions of MINN. STAT. ANN. § 56.19). If a lender intentionally violates the law, it is liable to the consumer in an amount not to exceed \$100. See *id.* § 56.19(2a).

212. Telephone Interview with Ron Elwood, *supra* note 201.

213. *Id.*

214. See MINN. STAT. ANN. § 47.60(5).

215. Telephone Interview with Ted Ellingson, Review Examiner, Comm'n of Commerce, Minn. Dep't of Banking (Feb. 27, 2006). There are four or five payday lenders in Minnesota that are licensed under the industrial loan authorization; these lenders receive regular examinations and audits under the stricter industrial loan regulations. *Id.*

has been violated.”<sup>216</sup> Even if consumers did complain, consumer advocates argue that the state lacks financial resources to effectively enforce the law.<sup>217</sup>

Minnesota’s statute also fails to protect borrowers from the debt treadmill.<sup>218</sup> While the statute prohibits rollovers, consumers can pay back one loan and immediately take out a new loan.<sup>219</sup> Consumers can also seek simultaneous payday loans from multiple lenders.<sup>220</sup> Further, the statute does not require lenders to ask whether consumers have outstanding loans,<sup>221</sup> so determined consumers and lenders can easily avoid the statute’s limits.

Despite the problems with Minnesota’s payday-loan law, its restrictions have deterred many payday lenders from entering the state.<sup>222</sup> As of October 2006, only fifty-eight payday-lending locations held licenses under Minnesota’s small-loan law.<sup>223</sup> In addition, four or five payday lenders are licensed under Minnesota’s more stringent industrial-loan law.<sup>224</sup> In comparison, Wisconsin has over 470 payday-loan locations.<sup>225</sup> Thus, while Minnesota’s law includes consumer-friendly substantive provisions that have deterred the expansion of the payday-loan industry in the state, it fails to protect consumers from the most troublesome features of payday loans.<sup>226</sup> Consequently, payday lending remains a serious problem for many Minnesota consumers.<sup>227</sup>

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216. *Senate Forum on Short-Term, High-Interest Paycheck Advances Before the S. Comm. Governmental Affairs*, 106th Cong. (1999), 1999 WL 1242421 (testimony of Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed’n of Am.).

217. Telephone Interview with Ron Elwood, *supra* note 201.

218. *See* Nixon et al., *supra* note 206.

219. *See id.*; *see also* Johnson, *supra* note 24, at 65-67 (“Most state statutes prohibiting or limiting rollovers . . . fail to take into account the determination of payday lenders to circumvent the law . . .”). *See generally* Chessin, *supra* note 27, at 410-17 (discussing statistics on rollovers in Colorado, where state law imposes a one-rollover limit).

220. *See* Nixon et al., *supra* note 206.

221. MINN. STAT. ANN. § 47.60(2)(f) (West 2006) (listing the requirement that consumers only have one payday loan at a time, but not imposing a duty on lenders to inquire into whether consumers have other outstanding loans).

222. Telephone Interview with Jean Ann Fox, *supra* note 29.

223. *See* Minn. Dep’t of Commerce, Regulated Lender List, <http://www.commerce.state.mn.us/pages/FinService/FSLicensees/rl> (last visited Jan. 28, 2007).

224. Telephone Interview with Ted Ellingson, *supra* note 215.

225. E-mail from Carrie Templeton, *supra* note 165.

226. Telephone Interview with Ron Elwood, *supra* note 201.

227. *See* Nixon et al., *supra* note 206.

### B. Florida

Florida's payday-loan law contains strong substantive provisions,<sup>228</sup> but consumer advocates claim that payday lenders take advantage of its loopholes and omissions to continue their harmful practices.<sup>229</sup> Florida law limits fees to 10% of the loan principal plus a verification fee,<sup>230</sup> allowing APRs of up to 390%.<sup>231</sup> Consumers cannot borrow more than \$500 at one time.<sup>232</sup> In addition, the law prohibits rollovers and concurrent loans,<sup>233</sup> and mandates a twenty-four-hour cooling-off period between loans.<sup>234</sup> This combination of measures limits consumers' ability to pay off one payday loan and immediately take out another. The statute also sets the minimum (seven days) and maximum (thirty-one days) loan terms.<sup>235</sup>

Two innovative features of Florida's statute provide more significant consumer protections. Payday lenders must give consumers a sixty-day interest-free grace period after the maturation date of the loan before commencing collection activities.<sup>236</sup> During this time, consumers

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228. See Missy Stoddard, *Loan Stores Go to Court*, SUN-SENTINEL (Ft. Lauderdale), July 4, 2005, at 1B ("[Jean Ann Fox] lauded Florida for enacting some of the strictest laws regulating the [payday-loan] industry.").

229. E.g., Graves & Peterson, *supra* note 59, at 741; Telephone Interview with Lynn Drysdale, Consumer Law Att'y, Jacksonville Area Legal Aid (Oct. 27, 2005); Jeff Ostrowski, *New Law Puts Curbs on Pricey "Payday" Loans*, PALM BEACH POST, Oct. 4, 2001, at 1D ("Some consumer advocates, such as the Florida Public Interest Research Group, say the new law doesn't go far enough because it doesn't limit the interest rates lenders can charge."); Gregory Richards, *Bill Targets Military Payday Loan Rates*, FLA. TIMES-UNION (Jacksonville), Oct. 11, 2006, at B1 (discussing a Jacksonville ordinance designed to address the problems that existed after passage of Florida's payday-loan law).

230. FLA. STAT. ANN. § 560.404(6) (West 2002) ("No deferred present provider or its affiliate shall charge fees in excess of 10 percent of the currency or payment instrument provided.").

231. See Richards, *supra* note 229.

232. See FLA. STAT. ANN. § 560.404(5) ("The face amount of a check taken for deferred presentment may not exceed \$500 exclusive of the fees allowed by this part.").

233. *Id.* § 560.404(18)-(19). This includes loans made from different lenders. See *id.* The statute defines "rollover" as "the termination or extension of an existing deferred presentment agreement by the payment of any additional fee and the continued holding of the check, or the substitution of a new check drawn by the drawer pursuant to a new deferred presentment agreement." *Id.* § 560.402(8).

234. See *id.* § 560.404(19).

235. *Id.* § 560.404(8). A longer term reduces a loan's APR. See *supra* note 69.

236. See *id.* § 560.404(22)(a). The statute requires lenders to inform consumers of their right to this grace period through written disclosures. See *id.* § 560.404(20).

must seek credit counseling.<sup>237</sup> This grace period, coupled with the prohibition of rollovers, gives consumers more time to pay back their loans. Further, the credit-counseling requirement helps educate consumers so they can avoid the debt treadmill.<sup>238</sup> Very few consumers, however, take advantage of this provision.<sup>239</sup>

Florida's payday-loan statute also mandated creation of a real-time enforcement database.<sup>240</sup> The Department of Banking and Finance partnered with Veritec Solutions, a private company, to create and maintain a payday-loan database.<sup>241</sup> Lenders enter a consumer's information into a central database, and the database software checks that consumer's eligibility for a loan against Florida's statutory restrictions.<sup>242</sup> If the consumer is ineligible for a loan under the statutory criteria, lenders cannot complete the loan transaction.<sup>243</sup> The database compiles payday-loan data and permits the Department of Banking and Finance to regularly access data reports.<sup>244</sup> Lenders pay a transaction fee of up to \$1 per loan to finance the database.<sup>245</sup>

In states that do not have a statutory database, many lenders use Tele-track, a subprime consumer-credit database, to assess risk.<sup>246</sup> Tele-track provides lenders with information about consumers' recent use of payday loans and other subprime financial products (for example,

237. *See id.* § 560.404(22)(a). If the credit counselor creates a repayment plan, the lender and the consumer may agree to that repayment plan instead of pursuing regular collection options. *See id.*

238. *See Johnson, supra* note 24, at 141-42.

239. In the one-year period from September 2005 to August 2006, only 0.51% of all payday-loan consumers took advantage of the grace period. VERITEC SOLUTIONS LLC, FLORIDA TRENDS IN DEFERRED PRESENTMENT: STATE OF FLORIDA DEFERRED PRESENTMENT PROGRAM (2006), [http://www.veritecs.com/FL\\_trends\\_aug\\_2006.pdf](http://www.veritecs.com/FL_trends_aug_2006.pdf).

240. *See* FLA. STAT. ANN. § 560.404(23).

241. Press Release, Veritec Solutions LLC, The State of Florida Selects Veritec Solutions (Dec. 5, 2001), [http://www.veritecs.com/selectveritec12\\_05\\_01.htm](http://www.veritecs.com/selectveritec12_05_01.htm).

242. *See* Veritec Solutions LLC, Applying Business Intelligence to Payday Lending Regulatory Solutions, <http://www.veritecs.com/PaydaySolution.htm> (last visited Jan. 28, 2007).

243. *Id.* *See generally* Questions and Answers Regarding Indiana's Small Loan Database Solution (2006), <http://www.in.gov/dfi/publications/UCCC/DatabaseGuidanceSLA.pdf> (discussing Indiana's payday-loan database, which is similar to Florida's database).

244. *See* FLA. DEP'T OF BANKING & FIN. DEFERRED PRESENTMENT PROGRAM, ANNUAL REPORT TO THE LEGISLATURE 14 (2003), *available at* <http://www.veritecs.com/Annualreport.pdf>.

245. *See* FLA. STAT. ANN. § 560.404(23) (West 2002); FLA. DEP'T OF BANKING & FIN. DEFERRED PRESENTMENT PROGRAM, *supra* note 244, at 4.

246. *See Johnson, supra* note 24, at 61-63 (describing the use of the Tele-track database by Ohio payday lenders). Some Wisconsin payday lenders also use Tele-track. *See Mayer, supra* note 25, at 8-9.

whether the consumer has outstanding loans or has defaulted on payday loans).<sup>247</sup> Lenders use the information to make their own determination about whether to extend a loan.<sup>248</sup> Thus, “The industry does not use Tele-track to *prevent* the phenomenon of ‘one payday, many payday loans’; rather, this system is used to *manage* the problem in order to maximize profits.”<sup>249</sup> In contrast, the Florida database prevents lenders from extending illegal loans.<sup>250</sup> Also, unlike Tele-track, the Florida database provides state regulators with valuable information about the payday-loan industry.<sup>251</sup>

Despite the initial fears of industry advocates, the payday-loan industry has expanded in Florida since the implementation of the new law. Veritec Solutions reported that loan-transaction volume in Florida increased by 1.1% per month between September 2005 and August 2006.<sup>252</sup> In that same time period, the number of payday-loan consumers in Florida increased by 21.1%.<sup>253</sup> Thus, Florida’s deferred-presentment statute has not stopped the growth of the payday-loan industry.

While Florida’s statute addresses some troublesome aspects of payday lending, problems still exist.<sup>254</sup> First, payday loans are still a debt trap for Florida consumers.<sup>255</sup> On average, Florida payday-loan consumers take out almost eight payday loans in one year.<sup>256</sup> Over half of all payday-loan transactions between September 2005 and August 2006 involved consumers with eleven or more payday loans.<sup>257</sup> These numbers do not include the payday loans that consumers requested in excess of Florida’s statutory limitations,<sup>258</sup> which suggests that at least some consumers would have borrowed even more.

Second, payday lenders can evade the law. For example, to avoid rollover restrictions, lenders provide loans to spouses or ask the consumer to come back in twenty-four hours for a new loan.<sup>259</sup>

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247. See Johnson, *supra* note 24, at 62 & n.311.

248. See *id.* at 62-63.

249. Mayer, *supra* note 25, at 9.

250. VERITEC SOLUTIONS LLC, *supra* note 239.

251. See FLA. DEP’T OF BANKING & FIN. DEFERRED PRESENTMENT PROGRAM, *supra* note 244, at 14.

252. See VERITEC SOLUTIONS LLC, *supra* note 239, at 3.

253. See *id.* at 9. The database keeps track of each “unique” consumer. See *id.*

254. Telephone Interview with Lynn Drysdale, *supra* note 202; Telephone Interview with Jean Ann Fox, *supra* note 29.

255. Telephone Interview with Jean Ann Fox, *supra* note 29.

256. VERITEC SOLUTIONS LLC, *supra* note 239, at 12.

257. See *id.*

258. See *id.* at 14. Lenders denied approximately 20% of the transaction requests in a one-year period. See *id.*

259. Telephone Interview with Lynn Drysdale, *supra* note 202.

Consumer advocates also claim that lenders do not disclose information regarding the grace period and other consumer protections, and some lenders blatantly violate the law by refusing to offer a grace period or by rolling over loans in violation of the statute.<sup>260</sup>

Some Florida payday lenders have even turned to alternative business models to avoid the payday-loan law. Cash America International, Inc. has begun offering loans through wholly owned credit-services organizations.<sup>261</sup> These organizations charge an annual interest rate of 18% plus a “broker fee” of \$18 per \$100 borrowed.<sup>262</sup> With the broker fee and the interest, these loans have an APR of almost 500%.<sup>263</sup> The broker fee, however, does not have to be included as interest in TILA disclosures.<sup>264</sup> Consumers must repay their loans within two weeks, and the organizations do not assess consumers’ ability to repay.<sup>265</sup> By offering loans through credit-services organizations, Cash America avoids the restrictions on payday lenders.<sup>266</sup>

To combat some of these problems, Jacksonville, Florida passed an ordinance in 2005 that imposed even tougher restrictions on payday lenders.<sup>267</sup> The ordinance capped interest rates at 36% APR for members of the military, prohibited payday lenders from operating within ten miles of military installations, and gave all consumers greater protections during lending disputes.<sup>268</sup> Two days after the Jacksonville City Council passed the law, Advance America Cash Advance Centers filed suit, arguing that state law preempted the additional restrictions in the Jacksonville ordinance.<sup>269</sup> A Florida circuit court ruled in Advance

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260. *Id.* For example, some lenders refuse to offer consumers the grace period, even though Florida’s statute requires it. *Id.* See also Graves & Peterson, *supra* note 59, at 741 (“Many payday lenders have actively sought to circumvent or ignore [Florida’s] rules.”).

261. See *Payday Loan Companies May Exploit State Credit Repair Acts to Evade Usury Laws*, NCLC REPS., CONSUMER CREDIT & USURY EDITION, July-Aug. 2006, at 1, 1-2.

262. *Id.* The broker fee goes to the credit-service organization, while the annual interest rate goes to a separate organization acting as a lender. See *id.*

263. See *id.*

264. Telephone Interview with Jean Ann Fox, *supra* note 29.

265. *Payday Loan Companies May Exploit State Credit Repair Acts to Evade Usury Laws*, *supra* note 261, at 1.

266. See *id.* This means that the credit-services organizations do not have to limit the amount of the loans or the fees. See *id.*

267. See Gregory Richards, *Payday Loan Law Target of Lawsuit*, FLA. TIMES-UNION (Jacksonville), Oct. 15, 2005, at B6.

268. Richards, *supra* note 229. For information about payday lenders targeting members of the military, see *supra* note 59.

269. See Richards, *supra* note 267.

America's favor,<sup>270</sup> and Jacksonville's City Council is currently considering a new version of the ordinance.<sup>271</sup>

Thus, while Florida's law succeeds in providing substantive consumer protections and a strong enforcement mechanism, the payday-loan industry has continued to grow in Florida. Payday loans are still a debt trap for consumers, and many consumer advocates believe that more protections are necessary.<sup>272</sup>

### C. Georgia

Georgia's law goes the farthest to protect consumers by making payday lending illegal.<sup>273</sup> Georgia's usury law limits the interest rate on loans of less than \$3,000 to 16% APR.<sup>274</sup> In 2002, Georgia's Attorney General released an Official Opinion stating that payday lending violated this usury restriction,<sup>275</sup> and Georgia's Industrial Loan Commissioner issued cease-and-desist orders against payday lenders.<sup>276</sup> Despite these actions, in 2004, Georgia's General Assembly found that illegal payday lending still existed.<sup>277</sup> Consequently, the legislature enacted a law specifically banning payday lending and increasing the criminal and civil penalties for violations.<sup>278</sup>

In addition, the Georgia legislature attempted to curtail payday lenders' ability to partner with out-of-state banks to avoid local usury

270. See *Advance Am. Cash Advance Ctrs. of Fla., Inc. v. Jacksonville, Fla., No. 16-2005-CA-7025-XXXX-MA* (Fla. Cir. Ct. June 1, 2006).

271. E-mail from Lynn Drysdale, Consumer Law Att'y, Jacksonville Area Legal Aid, Sept. 28, 2006 (on file with the Wisconsin Law Review).

272. See, e.g., Telephone Interview with Lynn Drysdale, *supra* note 202; Telephone Interview with Jean Ann Fox, *supra* note 29.

273. Payday lending was illegal in Georgia due to its usury limits, but the state legislature also recently passed a more specific law outlawing payday lending. See GA. CODE. ANN. § 7-4-2(a)(2) (2004) (creating a 16% usury limit); *id.* § 16-17-1(e) (“[T]he General Assembly declares that it is the general intent of this chapter to reiterate that in the State of Georgia the practice of engaging in activities commonly referred to as payday lending, deferred presentment services, or advance cash services and other similar activities are currently illegal . . .”).

274. *Id.* § 7-4-2(a)(2).

275. See *id.* § 16-17-1(b) (citing Ga. Att’y Gen., Official Opinion 2002-3 (2002), available at <http://www.ganet.org/ago/read.cgi?searchval=payday%20lending&openval=02-3>).

276. *Id.*

277. *Id.*

278. See *id.* § 16-17-1(c). The law also outlines factors that courts should consider in determining whether an arbitration clause included in a payday-loan contract is unconscionable. See *id.* § 16-17-2(c)(2).

limits,<sup>279</sup> a practice known as rent-a-bank.<sup>280</sup> Under the Federal Deposit Insurance Act, state-chartered banks can charge the interest rate permitted under the laws of its charter state in any other state where it does business.<sup>281</sup> The National Bank Act gives federally chartered banks a similar privilege.<sup>282</sup> Payday lenders who partner with these banks could charge the interest rate allowed in any state where the bank does business, even if the local state law is more restrictive.<sup>283</sup>

To prevent lenders from engaging in this practice, Georgia's statute prohibits in-state payday lenders from acting as agents for out-of-state banks when the in-state lender maintains a "predominant economic interest" in the loan,<sup>284</sup> or more than half of the loan revenues.<sup>285</sup> Payday lenders immediately challenged this portion of the law, claiming that the Federal Deposit Insurance Act preempted it.<sup>286</sup> While the lawsuit was pending before the Eleventh Circuit Court of Appeals, new Federal Deposit Insurance Corporation guidelines on payday lending became effective.<sup>287</sup> These guidelines increased federal oversight of bank partnerships with payday lenders by mandating strict capital requirements and limits on the "number and frequency of extensions, deferrals, renewals, and rewrites."<sup>288</sup> As a result, bank partnerships with payday lenders became unprofitable, and many banks left the industry, including those challenging Georgia's law.<sup>289</sup> Accordingly, the Eleventh

279. *See id.* §§ 16-17-1(c), -2(b)(4).

280. FOX & MIERZWINSKI, *supra* note 60, at 12; Johnson, *supra* note 24, at 105-06.

281. *See* 12 U.S.C. § 1831d(a) (2000).

282. *See id.* § 85. For a discussion of the rent-a-bank phenomenon as it relates to federally chartered banks, see Elizabeth R. Schlitz, *The Amazing, Expanding, Ever-Expanding Exportation Doctrine and Its Effect on Predatory Lending Regulation*, 88 MINN. L. REV. 518 (2004); Tasha L. Winebarger, Note, *The Beginning of the End: The Demise of Bank Partnerships with Payday Lenders*, 7 N.C. BANKING INST. 317 (2003); FOX & MIERZWINSKI, *supra* note 60, at 14-20.

283. *See, e.g.,* Winebarger, *supra* note 282, at 320-21.

284. GA. CODE ANN. § 16-17-2(b)(4).

285. *See BankWest, Inc. v. Baker*, 411 F.3d 1289, 1293 (11th Cir. 2005).

286. *See id.*

287. *See BankWest, Inc. v. Baker*, 446 F.3d 1358, 1362-63 (11th Cir. 2006) (explaining the impact of the new Federal Deposit Insurance Corporation (FDIC) guidelines on payday lenders in Georgia). The guidelines are available at FDIC, Guidelines on Payday Lending, <http://www.fdic.gov/regulations/safety/payday/>. The FDIC also sent letters to banks involved in payday lending, demanding that they create and present a plan for compliance with the guidelines. *See BankWest*, 446 F.3d at 1362-63.

288. FDIC, *supra* note 287.

289. *See BankWest*, 446 F.3d at 1362-63.

Circuit ruled that the challenge to Georgia's restrictions on bank partnerships was moot, and it dismissed the lawsuit.<sup>290</sup>

Georgia's ban on payday lending provides strong protections for consumers.<sup>291</sup> State legislators can do little more to protect consumers from the problems associated with payday loans. Thus, Georgia's statute provides a good model for states looking to outlaw payday lending entirely.

*D. Lessons from These States' Regulation of Payday Lenders*

The statutes of Minnesota, Florida, and Georgia represent the varied approaches state legislatures have taken to address the payday-loan problem. By examining these approaches, Wisconsin policymakers can determine not only what measures are needed to protect consumers, but how these measures should be drafted and enforced to ensure that payday lenders cannot evade the law or undermine its intent.<sup>292</sup> In this way, Wisconsin can benefit from other states' efforts.

Minnesota's statute shows that any effective payday-loan law must include a strong enforcement mechanism that does not put the burden of enforcement on consumers or the state. While the law includes consumer-friendly substantive provisions, the enforcement mechanism, driven by consumer complaints, permits lenders to break the law largely without consequence.<sup>293</sup> Financial regulators in Minnesota also lack the resources to properly investigate problems and audit payday lenders.<sup>294</sup> Other enforcement mechanisms based on audits or other actions by state regulators may face similar funding problems.<sup>295</sup>

Florida's real-time database solves this problem by requiring lenders to finance its privately managed enforcement database.<sup>296</sup> Consequently, database fees help to fund state enforcement officers, and state regulators did not need to greatly increase their budget to enforce the payday-loan law.<sup>297</sup> In addition, the database is proactive, not

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290. *Id.* at 1363.

291. See Editorial, *Don't Ease Up on Payday Lenders*, ATLANTA J. CONST., Dec. 7, 2004, at 14A. For arguments that banning payday lending is not the best tactic for consumers, see *infra* notes 301-07 and accompanying text.

292. For a discussion of the strengths and weaknesses of other states' laws, see Johnson, *supra* note 24, at 122-33.

293. Telephone Interview with Ron Elwood, *supra* note 201; Telephone Interview with Ted Ellingson, *supra* note 215.

294. Telephone Interview with Ron Elwood, *supra* note 201.

295. *Id.*

296. FLA. STAT. ANN. § 560.404(23) (West 2002).

297. Telephone Interview with Jean Ann Fox, *supra* note 29.

reactive.<sup>298</sup> Florida's enforcement mechanism prevents lenders from making illegal loans instead of punishing payday lenders for making illegal loans after the harm has been done.<sup>299</sup> Thus, a proactive enforcement system funded by lenders is superior to a reactive system that relies on state funding.<sup>300</sup>

Georgia's law expressly prohibits payday loans and attempts to close many loopholes that permitted lenders to continue harmful lending practices.<sup>301</sup> There are weaknesses to this approach as well. Because Georgia outlaws payday lending, desperate borrowers must find other sources for their short-term cash needs,<sup>302</sup> such as Internet loans<sup>303</sup> or alternative predatory lending products that could be just as harmful as payday loans.<sup>304</sup> For example, some lenders offer expensive open-ended lines of credit,<sup>305</sup> or create credit-services organizations to offer high-cost, short-term loans.<sup>306</sup> Further, the lack of short-term cash loans may drive some consumers into bankruptcy.<sup>307</sup> Wisconsin policymakers should consider these limitations when deciding whether to completely outlaw payday lending.

298. See Johnson, *supra* note 24, at 140-41 (noting that Florida's database prevents lenders and consumers from violating Florida's payday-loan law).

299. See *supra* notes 240-51 and accompanying text. Alabama, Illinois, Indiana, Michigan, and Oklahoma also have payday-lending laws that require a centralized enforcement database. See ALA. CODE § 5-18A-13(o) (LexisNexis Supp. 2005); 815 ILL. COMP. STAT. ANN. 122/2-15(a) (West Supp. 2006); IND. CODE ANN. § 24-4.5-7-404(1) (LexisNexis 2006); MICH. COMP. LAWS ANN. § 487.2142 (West Supp. 2006); OKLA. STAT. ANN. tit. 59, § 3109(B)(2) (West 2007).

300. While a proactive enforcement mechanism, such as a database, is an essential part of regulating payday lenders, it must be coupled with substantive limits to achieve any positive effects. Telephone Interview with Jean Ann Fox, *supra* note 29. A strong enforcement mechanism is irrelevant if it has nothing to enforce.

301. See GA. CODE ANN. § 16-17-1(c) (Supp. 2006).

302. See Mayer, *supra* note 174, at 81 (reviewing bankruptcy filings in Illinois, Wisconsin, and New Mexico to assess the impact of payday lending on bankruptcy petitions). "People in need of emergency cash will try to get it somewhere, and it is better for them if that source is legal and regulated." *Id.*

303. For more information about Internet payday lending, see generally FOX & PETRINI, *supra* note 79.

304. See Stegman, *supra* note 55, at 19 ("The reality is that decent, hard-working families who end up with too much month left at the end of their money will go underground if necessary to get help.").

305. See Erick Bergquist, *Credit Line Is Key in Pa. Payday Twist*, AM. BANKER, June 23, 2006, at 1 (discussing Advance America's extension of lines of credit for up to \$500 that carry a "participation" fee of \$149.95 per month in addition to principal and interest payments).

306. See *Payday Loan Companies May Exploit State Credit Repair Acts to Evade Usury Laws*, *supra* note 261, at 1-2.

307. See Frances B. Smith, *Payday Lending—Lessons from History*, CONSUMERS' RES. MAG., Apr. 23, 2003, at 34, 35.

In sum, by examining other states' experiences, Wisconsin can craft a law to adequately address the payday-loan problem. This law must include substantive protections, a strong enforcement mechanism, and measures to close the loopholes that unscrupulous lenders use to avoid consumer-friendly restrictions. Moreover, the law must be just one part of a multifaceted approach to addressing payday lending.

## V. HOW SHOULD WISCONSIN ADDRESS THE PAYDAY-LOAN PROBLEM?

Wisconsin has various options for addressing the payday-loan problem. This Part will discuss legislation; local action, including zoning ordinances, litigation, and financial education; and market measures. A combination of all three of these measures will be the most effective means of combating the payday-loan problem.

### A. Legislation

Legislation that specifically addresses payday lending is an essential component of any effort to limit the harmful practices of payday lenders.<sup>308</sup> It creates a baseline set of protections for consumers<sup>309</sup> and expresses a policy against harmful lending practices. Legislation alone, however, cannot protect consumers from the dangers of payday lending.<sup>310</sup> The suggested legislative restrictions will only curb harmful payday-lending practices if enacted in conjunction with other measures that prevent payday lenders from evading the law and reduce the demand for payday loans and other fringe-banking products.<sup>311</sup> Therefore, legislation represents just one part of a multifaceted solution to the payday-loan problem.

#### 1. WISCONSIN'S ATTEMPTS AT LEGISLATION

While Wisconsin does not currently have any legislation specifically addressing payday loans, legislators and regulators are concerned about the issue.<sup>312</sup> The Wisconsin legislature has made

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308. See FOX & MIERZWINSKI, *supra* note 60, at 24 (asserting that states must enact legislation to protect vulnerable consumers).

309. See Johnson, *supra* note 24, at 133 (listing the baseline consumers protections that legislators should include in a payday-lending law).

310. See *infra* Part V.D.

311. See *infra* Part V.B-D.

312. See Paul Gores, *Payday Loans Climb 18% to \$507 Million*, MILWAUKEE J. SENTINEL, July 26, 2005, at 1D ("Gov. Jim Doyle vetoed a Republican-sponsored bill last

multiple attempts to enact payday-loan legislation.<sup>313</sup> In 2004, Governor Jim Doyle vetoed a bill that he believed did not go far enough to protect consumers.<sup>314</sup> The proposed legislation limited the principal for payday loans to \$5,000 and rollovers to four,<sup>315</sup> but it did not limit fees or concurrent loans or create a system to track loans.<sup>316</sup>

The Wisconsin legislature rejected three payday-loan bills in the 2005 legislative session.<sup>317</sup> Senate Bill 328 would have limited interest rates for consumer credit transactions, including payday loans, to 18% APR.<sup>318</sup> Assembly Bill 914 would have restricted finance charges in payday-loan transactions to 2% per month.<sup>319</sup> Finally, Senate Bill 674 would have limited finance charges to no more than 5% of the face value of the postdated check and required a minimum term of thirty days.<sup>320</sup> All three bills failed to pass.<sup>321</sup>

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year that would have imposed limits on payday lending, saying the legislation wasn't strong enough. But that doesn't mean his administration is finished with the issue." According to the Wisconsin Democracy Campaign, the payday-loan industry was the top out-of-state contributor to lawmakers in the late 1990s. Steven Walters, *In 2 Years, Payday Lending Nearly Triples in Wisconsin*, MILWAUKEE J. SENTINEL, May 8, 2000, at 1A.

313. See Paul Gores, *Legislators to Take Another Crack at a Payday-Loan Law*, MILWAUKEE J. SENTINEL, Aug. 19, 2005, at 1D.

314. See Walters, *supra* note 34.

315. See Paul Gores, *Payday Loan Crackdown*, MILWAUKEE J. SENTINEL, Mar. 16, 2004, at 1D. Consumer advocates question any consumer's ability to repay a \$5,000 loan in two weeks at 500% APR. See Jean Ann Fox, Opening Remarks at the University of Wisconsin Payday Loan Forum, *supra* note 14.

316. See Paul Gores, *Some Hope Loan Bill Will Protect Consumers*, MILWAUKEE J. SENTINEL, Apr. 5, 2004, at 1D; Walters, *supra* note 34.

317. See History of Senate Bill 328, <http://www.legis.state.wi.us/2005/data/SB328hst.html> (last visited Jan. 11, 2007); History of Assembly Bill 914, <http://www.legis.state.wi.us/2005/data/ab914hst.html> (last visited Jan. 29, 2007); History of Senate Bill 674, <http://www.legis.state.wi.us/2005/data/SB674hst.html> (last visited Jan. 29, 2007).

318. See S. 328, 2005-2006 Leg., Reg. Sess. (Wis. 2005). This restriction would have applied to consumer loans for less than \$25,000. See *id.* Alternatively, the bill limited loans to an interest rate of 6% in excess of the interest rate on six-month U.S. treasury bills. See *id.*

319. See Assemb. 914, 2004-2005 Leg., Reg. Sess. (Wis. 2005).

320. See S. 674, 2005-2006 Leg., Reg. Sess. (Wis. 2006). This means that consumers would pay \$5 to borrow \$100 for thirty days. This transaction would have an APR of approximately 60%.

321. See *supra* note 317.

## 2. PROPOSED PAYDAY-LOAN LEGISLATION FOR WISCONSIN

Wisconsin should enact legislation that limits the harmful practices of payday lenders. This section will suggest various elements that should go into such legislation based on a model state statute proposed by the AARP Public Policy Institute<sup>322</sup> and other states' laws.

First, any payday-loan statute should be incorporated into the Wisconsin Consumer Act (WCA).<sup>323</sup> The WCA is a broad consumer-protection statute that the legislature intended as a means to protect consumers from "unfair, deceptive, false, misleading and unconscionable practices by merchants."<sup>324</sup> It regulates almost all aspects of consumer-credit transactions, including contract terms and enforcement through debt-collection practices.<sup>325</sup> For example, the WCA prohibits lenders from requiring consumers to waive their rights<sup>326</sup> and imposes a duty of good faith.<sup>327</sup> In addition, the WCA creates private rights of action for violations of its measures<sup>328</sup> and for other unconscionable practices.<sup>329</sup> By incorporating payday-loan restrictions into the WCA, consumers can be assured that its protections apply to payday loans.

Second, legislators should consider enacting a usury statute that limits interest rates to 36% APR. Many other states have taken this approach by enacting usury limits that prevent payday lenders from charging triple-digit interest rates.<sup>330</sup> Wisconsin also limits pawnbrokers—another segment of the fringe-banking industry<sup>331</sup>—to

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322. ELIZABETH RENUART, AARP PUB. POL'Y INST., PAYDAY LOANS: A MODEL STATE STATUTE 13-17 (2000), available at [http://assets.aarp.org/rgcenter/consume/d16954\\_payday.pdf](http://assets.aarp.org/rgcenter/consume/d16954_payday.pdf). Currently, payday lenders must comply with Wisconsin's small-loan-law licensing requirements. See WIS. STAT. § 138.09 (2005-2006).

323. WIS. STAT. chs. 421-27 (2005-2006).

324. *Id.* § 421.102(2)(b); see Jeffrey Davis, *Legislative Restriction of Creditor Powers and Remedies: A Case Study of the Negotiation and Drafting of the Wisconsin Consumer Act*, 72 MICH. L. REV. 3, 6 (1973); Edward J. Heiser, Jr., *Wisconsin Consumer Act—A Critical Analysis*, 57 MARQ. L. REV. 389, 389, 481 (1974).

325. See Heiser, *supra* note 324, at 389.

326. WIS. STAT. § 421.106(1).

327. *Id.* § 421.108.

328. See *id.* § 425.301.

329. See *id.* § 425.107.

330. See RENUART & KEEST, *supra* note 23, § 7.5.5.5; see also *supra* note 193 and accompanying text.

331. See Drysdale & Keest, *supra* note 27, at 597-600.

36% APR.<sup>332</sup> Finally, the Talent Amendment limits payday loans to members of the military in a similar fashion.<sup>333</sup>

Scholars argue that payday-loan legislation should limit interest rates because there is market failure in the payday-loan industry.<sup>334</sup> Many payday-loan consumers do not base their borrowing decisions on price.<sup>335</sup> Consumers may not understand the true cost of the loans and may focus instead on the low monthly payments, speed, or convenience.<sup>336</sup> Payday lenders principally compete based on location, speed, promotions or specials, and name recognition instead of price.<sup>337</sup> Further, many lenders discourage price shopping by refusing to disclose the interest rate and other loan terms until after the consumer applies for the loan.<sup>338</sup> Because payday-loan consumers often do not have complete information, most cannot price shop and create price competition.<sup>339</sup> Due to this market failure, increased competition between lenders has failed to lower payday-loan interest rates.<sup>340</sup> Studies show that, despite industry growth, payday-loan prices have increased or remained the same,<sup>341</sup> and, in states with interest-rate limits, rates cluster around the highest legal

332. WIS. STAT. § 138.10(4) (2005-2006). Wisconsin phased out other usury limits in the 1980s. *See id.* § 138.09(7).

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

334. *See, e.g.*, Johnson, *supra* note 24, at 117-18; Bertics, *supra* note 43, at 142-45.

335. *See Bertics, supra* note 43, at 143 (“[P]ayday borrowers are not particularly sophisticated, inhibiting their ability to price shop. Unsophisticated buyers will not appreciate the true cost that they are paying for goods and thus they will accept a higher price for the goods than if they had correct information.” (footnotes omitted)).

336. Block-Lieb & Janger, *supra* note 143, at 1538-48 (discussing borrowers’ “bounded rationality”—the inability to make rational utility-maximizing choices due to a lack of effort in gathering information or decisional biases—and why consumers become involved with predatory lending).

337. *See Bertics, supra* note 43, at 143; Chessin, *supra* note 27, at 409; Hellwig, *supra* note 141, at 1597. Payday lenders may be hesitant to compete based on price because TILA requires advertisements that list credit prices to include the APR. *See* 15 U.S.C. § 1664(d) (2000).

338. *See Bertics, supra* note 43, at 139; Johnson, *supra* note 24, at 42-49.

339. *See Bertics, supra* note 43, at 143; Johnson, *supra* note 24, at 118; *see also* Willis, *supra* note 142, at 809-11 (discussing the lack of price information available to consumers in the subprime mortgage market). Consumers may also be too embarrassed about needing to seek a loan to ask friends and family for advice or seek out multiple lenders. *See Hellwig, supra* note 141, at 1585-86.

340. *See FOX & MIERZWINSKI, supra* note 60, at 13-14; Drysdale & Keest, *supra* note 27, at 660; Johnson, *supra* note 24, at 117-18.

341. *See Johnson, supra* note 24, at 117.

interest rate.<sup>342</sup> Therefore, interest-rate caps could correct this market failure.

Interest-rate caps represent a preventative approach to regulation.<sup>343</sup> While these caps restrict the availability of credit, particularly to high-risk consumers, this restriction may help more than harm.<sup>344</sup> Unregulated interest rates force low-risk consumers to pay higher interest rates than necessary to receive a loan.<sup>345</sup> For high-risk consumers, high interest rates may increase the probability of default.<sup>346</sup> Interest-rate caps can limit harm to consumers by creating a price ceiling and preventing unfair and deceptive practices.<sup>347</sup> Further, “Prevention is not necessarily a bad policy when unfettered freedom of choice presents potentially serious negative consequences.”<sup>348</sup> For example, excessive societal debt can negatively affect the national economy or raise prices on consumer goods.<sup>349</sup>

There are limitations to using an interest-rate cap to regulate payday lending. Most importantly, Wisconsin legislators are reluctant to support them.<sup>350</sup> Any potential legislation must be politically viable or its ability to protect consumers is moot. In addition, industry advocates argue that high interest rates result from high risk and high demand—not market failure.<sup>351</sup> They believe that limiting interest rates constitutes paternalism: consumers understand the cost of payday lending and accept the risks.<sup>352</sup> Even some consumer advocates caution against setting the legal interest rate too low, because if the payday-loan industry were to

342. See Chessin, *supra* note 27, at 408-09; Written Testimony of Jean Ann Fox, *supra* note 96, at 7.

343. Drysdale & Keest, *supra* note 27, at 663. See generally George J. Wallace, *The Uses of Usury: Low Rate Ceilings Reexamined*, 56 B.U. L. REV. 451, 458-60 (1976).

344. See Drysdale & Keest, *supra* note 27, at 661, 663-64.

345. See *id.* 662-63

346. See *id.*

347. See *id.* at 663; Wallace, *supra* note 343, at 461-68.

348. Drysdale & Keest, *supra* note 27, at 663.

349. See Hellwig, *supra* note 141, at 1578-80 (listing the damages to society from high debt levels); Drysdale & Keest, *supra* note 27, at 663-64 (discussing how usury limits might help society); Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 177-78 (1988) (“[T]here is little doubt that in a recession all consumers suffer, overleveraged consumers suffer most, and the more overleveraged our population is, the more our society will suffer.”).

350. See, e.g., Weier, *supra* note 124. (quoting legislators discussing the limitations of a payday-lending bill that included an interest-rate cap).

351. See Schaaf, *supra* note 69, at 349.

352. See *id.* at 349-50; Steven W. Bender, *Rate Regulation at the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard*, 31 HOUS. L. REV. 721, 730 (1994).

collapse, consumers would be forced to turn to other, potentially more troublesome sources for short-term cash loans.<sup>353</sup> Still, payday lenders could maintain profitability by restructuring their products to become longer-term installment loans.<sup>354</sup> Legislators should consider these limitations when contemplating an interest-rate cap.<sup>355</sup>

Third, payday-loan legislation should mandate that lenders accept installment payments instead of requiring one balloon payment.<sup>356</sup> If consumers can pay down the principal without rolling over the loan, lenders would still earn the fee charged on the original loan, and consumers would avoid the debt treadmill by paying off their loan instead of just delaying payment.<sup>357</sup> A few Wisconsin payday lenders currently permit consumers to pay down their principal when rolling over their loan.<sup>358</sup>

Fourth, payday-loan legislation should prohibit rollovers. Rollovers pose serious problems for consumers because they trap consumers on a debt treadmill.<sup>359</sup> Because many consumers lack funds to pay back their payday loans at maturity and must roll over their loans or seek another loan,<sup>360</sup> rollovers can turn small, short-term financial problems into large, long-term ones as consumers pay fees without reducing the principal.<sup>361</sup> To make the rollover prohibition more effective, the legislation should mandate a seventy-two-hour cooling-off period to prevent lenders from re-extending loans after a short period of time.

In conjunction with the prohibition on rollovers, legislators should require a sixty-day grace period for payday-loan consumers.<sup>362</sup> A grace

353. See Mayer, *supra* note 174, at 81; Bertics, *supra* note 43, at 147 & n.136. One study estimated that the break-even point for payday lenders was 130% APR. *Id.* at 153 (citing JERRY BUCKLAND ET AL., THE RISE OF FRINGE BANKING SERVICES IN WINNIPEG'S NORTH END: CLIENT EXPERIENCES, FIRM LEGITIMACY, AND COMMUNITY BASED ALTERNATIVES app. G(C) (2003)).

354. Telephone Interview with Jean Ann Fox, *supra* note 29. For example, credit-card cash advances, while expensive, do permit consumers to repay their loan in installments. See, e.g., Citibank, Cash Advances, <http://www.citibank.com/us/cards/cm/ccwork06.htm> (last visited Jan. 29, 2007).

355. In *Wisconsin Auto Title Loans v. Jones*, Justice Butler's concurring opinion urged the legislature to adopt an interest-rate cap for another predatory loan product, auto title loans, because "[a]nything less short-changes the public." See 2006 WI 53, ¶ 95, 290 Wis. 2d 514, 714 N.W.2d 155 (Butler, J., concurring).

356. See Mayer, *supra* note 174, at 81; Barr, *supra* note 47, at 163.

357. See Johnson, *supra* note 24, at 59-60.

358. HENDRIX & NOYES, *supra* note 180, at 6-7.

359. See Johnson, *supra* note 24, at 128.

360. See *supra* notes 72-76 and accompanying text.

361. See Written Testimony of Jean Ann Fox, *supra* note 96, at 8; Walters, *supra* note 2.

362. See, e.g., FLA. STAT. ANN. § 560.404(22) (West Supp. 2006).

period gives consumers time to receive credit counseling, repay their debt obligations,<sup>363</sup> receive several paychecks, and deal with financial emergencies. This would help consumers avoid the debt treadmill and educate them so they can build positive financial habits.<sup>364</sup>

Fifth, legislators should consider requiring lenders to assess a consumer's ability to repay loans and limiting the amount that consumers can borrow depending on their income. Indiana's payday-loan statute limits consumers to borrowing 15% of their net monthly income.<sup>365</sup> This limitation prevents consumers from pledging their entire next paycheck or more to payday lenders and decreases the possibility of default.<sup>366</sup> In addition, Wisconsin legislators could also "require lenders to inquire about, and limit loans based on, large expenses such as housing and car payments."<sup>367</sup> While this would impose greater responsibilities on lenders,<sup>368</sup> it would also prevent consumers from becoming further overwhelmed by debt.

Sixth, payday-loan legislation should prohibit lenders from making loans of more than \$300, and require the term of the loan to be at least two weeks for each \$50 owed.<sup>369</sup> These provisions would ensure that consumers use payday loans for short-term emergency needs, and that they are able to repay their loans on time.<sup>370</sup>

Finally, legislators should ensure that strong mechanisms exist to enforce these substantive regulations. Specifically, legislators should require creation of a real-time enforcement database similar to the system implemented in Florida.<sup>371</sup> By forcing lenders to verify that the loan complies with the law's prohibitions on rollovers and concurrent loans, a database would proactively prevent lenders from making illegal loans.<sup>372</sup> A database does not require an increase in the state regulatory budget or staff because it could be funded by the industry.<sup>373</sup> It also provides

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363. See Johnson, *supra* note 24, at 141-42.

364. See *id.*

365. See IND. CODE ANN. § 24-4.5-7-402(1) (LexisNexis 2006).

366. See Mayer, *supra* note 25, at 5-6 (discussing bankruptcy petitioners who had pledged their entire next paycheck or more to payday lenders).

367. See Johnson, *supra* note 25, at 140 (suggesting this approach, which is currently used by mortgage lenders).

368. See *id.*

369. RENUART, *supra* note 336, at 17.

370. See *id.* at 18; Chin, *supra* note 14, at 749.

371. See FLA. STAT. ANN. § 560.404(19)(a) (West Supp. 2006).

372. See Johnson, *supra* note 25, at 140-41; *supra* notes 250-62 and accompanying text.

373. Mayer, *supra* note 25, at 9. While Wisconsin would need to maintain its staff to review the database reports and do additional audits, it would likely not need to

regulators with valuable information about the payday-loan industry.<sup>374</sup> Although industry advocates complain that tracking mechanisms are not used for other credit industries,<sup>375</sup> payday loans differ from other forms of credit due to their short-term, high-cost nature and because lenders do not perform credit checks. These differences justify imposition of a database to enforce lending restrictions.<sup>376</sup>

In addition, payday-loan legislation must provide consumers with an incentive to bring lawsuits against lenders who violate the law. If a consumer succeeds in a court action against a lender, the payday-loan transaction should be void under Wisconsin Statutes section 425.305.<sup>377</sup> This remedy permits a consumer to regain all of the money pledged towards the transaction, eliminates any remaining debt, and requires the lender to pay the consumer's attorney's fees.<sup>378</sup> It also deters lenders from attempting to violate the law.

Wisconsin legislators should act to specifically deal with the problems created by payday lending.<sup>379</sup> In general, effective legislation should include rollover caps, limits on concurrent loans, repayment plans for consumers in default, a requirement that lenders inquire into consumers' ability to pay, and an enforcement database.

### B. Local Action

While legislation can curb some of the problems associated with payday lending, it alone is not enough. Consumer advocates can limit the effects of payday lending on their communities by lobbying for zoning ordinances, bringing lawsuits against payday lenders to police their practices, and promoting financial education.

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hire more inspectors, and the database fees would help to offset the expenses associated with enforcement.

374. See, e.g., VERITEC SOLUTIONS LLC, *supra* note 239.

375. Gores, *supra* note 316.

376. Mayer, *supra* note 25, at 9.

377. This section of the statute also provides a remedy for violation of the laws governing credit-services organizations, default charges, and repossession. See, e.g., WIS. STAT. §§ 422.503, 422.413, 425.206 (2005-2006).

378. WIS. STAT. §§ 425.305, .308.

379. Walters, *supra* note 34.

## 1. ZONING

As a result of consumer advocates' actions, many communities have enacted zoning ordinances to limit the operation of payday lenders.<sup>380</sup> These ordinances often require payday lenders to acquire "special use" permits after public hearings.<sup>381</sup> To obtain such a permit, a lender must prove that opening a payday-loan store at the desired location would not harm the public health, safety, or welfare.<sup>382</sup>

Ordinances in Milwaukee, Wisconsin require payday lenders to obtain special-use permits from the zoning board.<sup>383</sup> Board members consider the impact of the proposed payday lender based on four criteria: (1) protection of public health, safety, and welfare; (2) protection of property, including property use, value, and enjoyment; (3) traffic and pedestrian safety; and (4) consistency with a comprehensive plan.<sup>384</sup> Before voting, the board must hold a public hearing and invite the lender and owners of property surrounding the proposed site of the payday-loan business.<sup>385</sup> At these hearings, consumers can voice their disapproval of payday lending and articulate why lenders do not meet the four criteria.<sup>386</sup> Milwaukee community groups have successfully used this procedure to stop individual payday lenders from opening new locations within city limits.<sup>387</sup>

Because zoning boards can consider the public health, safety, and welfare when determining whether to grant a special-use permit, community groups should present evidence to the zoning board of the

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380. James Walrath, Att'y, Legal Aid Soc'y of Milwaukee, Inc., Address at the University of Wisconsin Payday Loan Forum (Sept. 22, 2005).

381. *Id.*

382. *Id.* The burden is on the payday lender. *Id.*

383. See Felicia Thomas-Lynn, *Payday Loan Denied Special Use Permits*, MILWAUKEE J. SENTINEL, July 26, 2003, at B5.

384. See MILWAUKEE, WIS., CODE OF ORDINANCES § 295-311-2-d (2006).

385. See *id.* § 295-311-2-b.

386. See, e.g., Letter from Grant F. Langley, City Att'y for the City of Milwaukee, et al., to Craig Zetley, Chairman, Bd. of Zoning Appeals for the City of Milwaukee 3 (May 7, 2003) (on file with the Wisconsin Law Review); City of Milwaukee Board of Zoning Appeals, What to Know About Special Use Permits, <http://www.mkedcd.org/boza/su.html> (last visited Jan. 29, 2007) ("When making a decision on your special use application, the Board considers the recommendations submitted by the departments, information submitted by the alderman of the district, information from property owners in the immediate area and any other interested parties.").

387. See, e.g., Thomas-Lynn, *supra* note 383; Address of James Walrath at the University of Wisconsin Payday Loan Forum, *supra* note 380.

adverse secondary effects of payday lending on the community.<sup>388</sup> One secondary impact that zoning boards could consider is the “clustering” or oversaturation of payday lenders.<sup>389</sup> The presence of many payday lenders in a small geographic area suggests that the area is home to high-risk credit consumers.<sup>390</sup> This image can negatively affect other area businesses and the potential for future development.<sup>391</sup> Payday lenders may also increase the burden on local nonprofit and government agencies such as consumer credit-counseling services, legal aid offices, and courts.<sup>392</sup>

Other zoning ordinances set restricted hours, signage limitations, per capita limitations, spatial separation or distance requirements (either from other lenders or from residential or other types of property), and security requirements.<sup>393</sup> Additionally, Wisconsin courts have upheld zoning regulations excluding certain businesses from particular zoning districts as long as those businesses may still operate somewhere in the jurisdiction.<sup>394</sup>

Several Wisconsin cities have successfully used these kinds of zoning ordinances to exclude or limit the growth of payday lenders: Racine and West Allis restrict how close payday lenders can be to one

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388. Address of James Walrath at the University of Wisconsin Payday Loan Forum, *supra* note 380 (giving strategies for proving to zoning boards that payday lenders create adverse secondary effects); *Edward Kraemer & Sons, Inc. v. Sauk County Bd. of Adjustment*, 183 Wis. 2d 1, 11, 515 N.W.2d 256, 260 (1994) (“The public health, safety and welfare standard is also broad enough to enable the Board to consider the generalized effects on the public welfare that concern the Board in this case . . . .”); *Sills v. Walworth County Land Mgmt. Comm.*, 2002 WI App 111, 254 Wis. 2d 538, 648 N.W.2d 878 (confirming, in the context of a historical site, that a zoning board may consider community-wide secondary effects of a proposed use in determining how the land use would effect the general welfare).

389. See Letter from James A. Walrath, Executive Dir., Legal Aid Soc’y of Milwaukee, Inc., to Craig Zetley, Chairperson, Bd. of Zoning Appeals for the City of Milwaukee, & Don Richards, Alderman, City of Milwaukee Common Council 2-3 (Sept. 24, 2003) [hereinafter Walrath Letter] (on file with the Wisconsin Law Review); Address of James Walrath at the University of Wisconsin Payday Loan Forum, *supra* note 380.

390. Walrath Letter, *supra* note 389, at 2.

391. See *id.*

392. *Id.* at 3-4.

393. Address of James Walrath at the University of Wisconsin Payday Loan Forum, *supra* note 380.

394. See Letter from Grant F. Langley to Craig Zetley, *supra* note 386, at 6 (“[I]n a few contexts, zoning regulations excluding certain businesses from particular zoning districts or sections of a local jurisdiction have been upheld on the basis of proven adverse secondary impacts upon the general public in those specific geographical areas.” (citing *City of Renton v. Playtime Theatres, Inc.*, 475 U.S. 41 (1986), and *Young v. Am. Mini Theatres, Inc.*, 427 U.S. 50 (1976))).

another.<sup>395</sup> Kenosha regulates payday lending locations and hours.<sup>396</sup> Wauwatosa imposed a one-year moratorium on new payday-loan stores in 2006 to allow debate on permanent restrictions.<sup>397</sup> Madison and Superior are also considering measures similar to those of Racine and West Allis.<sup>398</sup>

Cities can also use ordinances to limit payday lenders' business operations if state law does not preempt such provisions.<sup>399</sup> In *Payday Loan Store of Wisconsin, Inc. v. City of Madison*, a federal district court upheld an ordinance that required payday lenders to close overnight.<sup>400</sup> Nevertheless, cities may find it difficult to regulate lending practices through ordinances.<sup>401</sup> The Wisconsin Supreme Court held that state regulation of the credit practices of state-chartered savings and loan associations preempted an ordinance that barred discrimination based on marital status in mortgage lending.<sup>402</sup> Similarly, courts could bar cities from regulating payday-loan interest rates because the state law regulating lenders, which currently rejects interest-rate caps, could preempt city ordinances.<sup>403</sup>

## 2. LITIGATION

Local groups can also combat the worst problems associated with payday lending through litigation. In addition to suing payday lenders for TILA violations,<sup>404</sup> consumers can challenge payday lenders' contracts and fees using the doctrine of unconscionability.<sup>405</sup> Consumers can

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395. Annysa Johnson, *Payday Loan Stores in Crosshairs*, MILWAUKEE J. SENTINEL, Sept. 21, 2006, at B6.

396. See E-mail from Ray Misner, Alderman, City of Kenosha, to author (Oct. 30, 2006) (on file with the Wisconsin Law Review).

397. Johnson, *supra* note 395.

398. *Id.*

399. See Letter from Grant F. Langley to Craig Zetley, *supra* note 386, at 8-9.

400. See 333 F. Supp. 2d 800, 802 (W.D. Wis. 2004). The court determined that the city had a rational basis for this restriction because of fears of criminal activity. See *id.* at 804-05.

401. See Letter from Grant F. Langley to Craig Zetley, *supra* note 386, at 8-9.

402. See *Anchor Savings & Loan Ass'n v. Madison Equal Opportunities Comm'n*, 120 Wis. 2d 391, 355 N.W.2d 234 (1984). Because the *Payday Loan Store* ordinance dealt with issues not contemplated by state law—hours of operation and location of business—the court distinguished the case from *Anchor Savings*. See 333 F. Supp. 2d at 808.

403. See Letter from Grant F. Langley to Craig Zetley, *supra* note 386, at 7-9.

404. See *supra* notes 133-47 and accompanying text; see also Wilson, *supra* note 133.

405. See Bruch, *supra* note 22, at 1278-84 (arguing that payday loans are both substantively and procedurally unconscionable); see also Bender, *supra* note 352, at 777;

pursue unconscionability claims under Wisconsin statutes and common law.<sup>406</sup> While the doctrine of unconscionability is difficult to define, it “has often been described as the absence of meaningful choice on the part of one of the parties, together with contract terms that are unreasonably favorable to the other party.”<sup>407</sup> Courts analyze contracts for substantive unconscionability (that is, commercially unreasonable contract terms) and procedural unconscionability (that is, a lack of meaningful choice in making the contract).<sup>408</sup> Using this two-part standard, consumers can challenge the fairness of payday lenders’ terms and avoid their obligations under their payday-loan contracts.<sup>409</sup>

In the context of payday lending, consumers can argue that the loan contracts are substantively unconscionable because they charge excessive interest rates and are unreasonably favorable to the lenders, and because there is a gross disparity between the price of the loan and the value obtained by the borrower.<sup>410</sup> Payday-loan contracts may be procedurally unconscionable if the parties have unequal bargaining power, the consumer cannot exercise a meaningful choice, or the lender uses deception or surprise to take advantage of the consumer.<sup>411</sup>

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Chin, *supra* note 14, at 743-49 (arguing that consumers should use the unconscionability doctrine in conjunction with federal and state usury laws, but that it is ineffective on its own). It is not easy to prevail on a claim of unconscionability. *See infra* notes 419-24 and accompanying text. Nevertheless, Wisconsin courts have recently used the doctrine to strike down arbitration clauses in two consumer-credit transactions. *See Wis. Auto Title Loans, Inc. v. Jones*, 2006 WI 53, 290 Wis. 2d 514, 714 N.W.2d 155; *Coady v. Cross Country Bank, Inc.*, No. 05AP2770 (Wis. Ct. App. Jan. 25, 2007), <http://www.wicourts.gov/ca/opinion/DisplayDocument.pdf?content=pdf&seqNo=27918>. While these cases deal with arbitration clauses instead of contracts in general, they show that Wisconsin courts are willing to consider arguments based on unconscionability, and they bode well for the future use of the doctrine by consumers.

406. *See, e.g.*, WIS. STAT. § 425.107 (2005-2006); *Wis. Auto Title Loans*, 2006 WI 53; *see also Hume v. United States*, 132 U.S. 406, 413 (1889) (holding that courts may refuse to enforce unconscionable contracts). *See generally* U.C.C. § 2-302(1) (2005).

407. *Wis. Auto Title Loans*, 2006 WI 53, ¶ 32.

408. *See, e.g., id.* ¶¶ 33-36. While courts typically require proof of both procedural and substantive unconscionability, substantive unconscionability alone may render a contract unenforceable. *See Bender, supra* note 352, at 749-51.

409. *See* WIS. STAT. § 425.107(1), (5).

410. *See Bender, supra* note 352, at 749 n.150 (listing cases that found substantive unconscionability in regard to prices or interest rates); Bruch, *supra* note 21, at 1278-81 (arguing that payday loans are substantively unconscionable because they are one-sided and because lenders know borrowers will be unable to repay their loans). Some factors that Wisconsin courts may consider when evaluating a claim of unconscionability are listed in Wisconsin Statutes section 425.107(3). *See also Wis. Auto Title Loans*, 2006 WI 53, ¶¶ 35-36 (listing some criteria for a finding of substantive unconscionability).

411. *Wis. Auto Title Loans*, 2006 WI 53, ¶ 34 (listing criteria for a finding of procedural unconscionability); Bruch, *supra* note 21, at 1282-84. *See generally* WIS. STAT. § 425.108(3) (listing factors courts may consider).

Using litigation and the doctrine of unconscionability to challenge payday lenders' practices lessens the need for a strong payday-loan law.<sup>412</sup> Because the doctrine of unconscionability operates in the law of contracts, lenders cannot easily evade its application.<sup>413</sup> The doctrine is flexible; it enforces fairness in relation to specific consumers instead of creating an arbitrary limit on lenders' behavior.<sup>414</sup>

In practice, there have been few Wisconsin cases against payday lenders. Moreover, most of these cases settled or did not result in published opinions.<sup>415</sup> For example, in *Dienes v. McKenzie Check Advance of Wisconsin*, three plaintiffs brought a class-action lawsuit against the payday lender National Cash Advance using the doctrine of common-law unconscionability.<sup>416</sup> While the lawsuit was pending, National Cash Advance implemented a retroactive arbitration agreement that reduced the size of the class from over 20,000 people to just over 11,000,<sup>417</sup> leading the parties to settle the case for \$1.4 million in cash and debt relief.<sup>418</sup> Because the case settled, however, the court did not analyze the plaintiffs' claims, and it did not create precedent on the use of the doctrine of unconscionability against payday lenders.

There are several reasons that explain why there have been few cases against payday lenders in Wisconsin.<sup>419</sup> The doctrine of unconscionability is inherently uncertain; courts apply it in different ways and must examine the contracts using subjective, fact-based analyses.<sup>420</sup> This makes it difficult for attorneys and businesses to predict when a court will deem a transaction to be unconscionable and may lead to higher caseloads and litigation costs.<sup>421</sup> Consumers may also have difficulty succeeding in unconscionability claims due to the difficulty in

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412. See Bender, *supra* note 382, at 739-41; Chin, *supra* note 14, at 744 (discussing the advantages of using unconscionability over usury laws).

413. Bender, *supra* note 352, at 740; Chin, *supra* note 14, at 744.

414. See Bender, *supra* note 352, at 740-41.

415. See, e.g., Cary Segall, *The Cash Store Agrees to \$78,000 Settlement in Class-Action Lawsuit*, WIS. ST. J., Aug. 26, 1999, at 4B (discussing the settlement agreement in *Davis v. The Cash Store Ltd.*).

416. See No. 99-C-50, 2000 WL 34511333, at \*1 (E.D. Wis. Dec. 11, 2000) (certifying the class action on two counts: common-law unconscionability and statutory attorneys' fees).

417. See *id.* at \*4; Nicole Sweeney, *Payday Loan Company Settling Lawsuit for \$1.4 Million*, MILWAUKEE J. SENTINEL, Mar. 29, 2002, at B3.

418. Sweeney, *supra* note 417.

419. See Chin, *supra* note 14, at 745-48 (discussing the problems with using litigation to enforce borrowers' rights).

420. *Id.* at 746.

421. See *id.* Because of the lack of clear standards, lenders may not know whether their loan contracts are valid. *Id.*

determining the fair interest rate for each transaction.<sup>422</sup> Using this case-by-case method of enforcement creates high transaction costs for consumers, and they may be unable to find legal representation to bring their claims.<sup>423</sup> Even when consumers succeed, their victories may be limited, as lenders can change their contracts and continue their harmful practices. Moreover, litigation places the burden of enforcing the law on consumers, even though many consumers do not understand the law and may lack the resources to seek legal assistance.<sup>424</sup>

Litigation as a means of regulating payday lenders is also limited by the use of arbitration clauses.<sup>425</sup> Most payday lenders require consumers to consent to mandatory arbitration and waive their right to a jury trial.<sup>426</sup> While consumers can attack arbitration clauses as unconscionable,<sup>427</sup> this additional step further increases the difficulty and cost of litigation. Indeed, many of the reported cases against payday lenders nationwide focus on the validity of arbitration agreements instead of the consumers' substantive claims.<sup>428</sup> Arbitration clauses may also deter consumers from pursuing remedies through litigation.<sup>429</sup> Moreover, even if consumers do

422. *Id.* at 747; Bender, *supra* note 352, at 776-78.

423. *See* Morris, *supra* note 349, at 173-74 (discussing the high transaction costs associated with attacking contracts for unconscionability). Wisconsin law also limits the use of class actions for claims of statutory unconscionability; plaintiffs cannot bring statutory unconscionability claims unless an appellate court has found the practice unconscionable at least thirty days before the conduct that prompted the lawsuit. *See* Wis. STAT. § 426.110(3) (2005-2006).

424. Bender, *supra* note 352, at 745 & n.129; Hellwig, *supra* note 141, at 1586-87.

425. Address of James Walrath at the University of Wisconsin Payday Loan Forum, *supra* note 380.

426. *Id.*; Johnson, *supra* note 24, at 48; Debra L. Schneider & Michael J. Quirk, *Mandatory Arbitration of Consumer Rights Cases*, Wis. LAW., Sept. 2002, at 14, 16 ("Consumers may be unaware that arbitration materially changes the rules of dispute resolution so that the right to a jury trial is eliminated . . .").

427. In a recent case, *Wisconsin Auto Title Loans, Inc. v. Jones*, the Wisconsin Supreme Court determined that an auto title loan company's mandatory arbitration clause was unconscionable as applied to a specific consumer. *See* 2006 WI 53, ¶ 4, 290 Wis. 2d 514, 714 N.W.2d 155. While this case represents a remarkable victory for Wisconsin consumers, its holding was fact-specific, *see id.* ¶ 42; *id.* ¶ 98 (Roggensack, J., dissenting), which may limit its applicability as precedent.

428. *See, e.g.*, Jenkins v. First Am. Cash Advance of Ga., LLC, 400 F.3d 868 (11th Cir. 2005); Evans v. Direct Gen. Ins. Agency, Inc., No. 4:04CV00942, 2005 U.S. Dist. LEXIS 4801 (E.D. Ark. Mar. 11, 2005); Furgason v. McKenzie Check Advance of Ind., Inc., No. IP 00-121-C H/G, 2001 U.S. Dist. LEXIS 2725 (S.D. Ind. Jan. 3, 2001); Johnson v. Tele-Cash, Inc., No. 99-104-GMS, 1999 U.S. Dist. LEXIS 20653 (D. Del. Dec. 29, 1999); McKenzie Check Advance of Miss., LLC v. Hardy, 866 So. 2d 446 (Miss. 2004).

429. *See* Schneider & Quirk, *supra* note 426, at 16.

win in arbitration, arbitration decisions are not reported<sup>430</sup> and cannot be relied upon as precedent.

Despite these limitations, litigation remains a viable means of attacking the worst payday-lending practices.<sup>431</sup> Accordingly, consumer advocates should continue to pursue litigation as a means of regulating payday lenders. To be successful, they should prove that the consumers were uneducated or inexperienced in financial matters, were desperate for the loan, and did not have the opportunity to bargain over the contract terms.<sup>432</sup> Consumer advocates should also seek to bring lawsuits against lenders that do not explain the terms of their transactions to consumers and that use contracts with substantively unreasonable terms or limited remedies.<sup>433</sup>

### 3. FINANCIAL EDUCATION

Concerned communities may also try to lessen the demand for payday loans by investing in financial education.<sup>434</sup> Increased financial education helps consumers understand the true cost of payday loans, alternatives to the fringe-banking industry, and how to manage money to avoid financial emergencies.<sup>435</sup> Studies have shown that financial education can increase consumers' savings levels, thus preparing them to deal with short-term cash-flow issues.<sup>436</sup> By reducing the demand for payday loans, financial education could force lenders to adopt better practices and allow consumers to escape the debt treadmill.<sup>437</sup>

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430. *Id.* at 16-17.

431. The Northern District of Illinois has granted class certification in a number of common-law unconscionability claims against payday lenders. *See, e.g.*, *Pinkett v. Moolah Loan Co.*, No. 99C2700, 1999 WL 1080596 (N.D. Ill. Nov. 2, 1999); *Davis v. Cash for Payday, Inc.*, 193 F.R.D. 518, 522 (N.D. Ill. Apr. 26, 2000); *Donnelly v. Illini Cash Advance, Inc.*, No. 00C094, 2000 WL 1161076 (N.D. Ill. Aug. 16, 2000).

432. *See Wis. Auto Title Loans*, 2006 WI 53, ¶ 43 (discussing facts that supporting a finding of procedural unconscionability).

433. *See id.* ¶ 60 ("In many of the cases in which a contract provision has been held to be substantively unconscionable, a creditor has unduly restricted a debtor's remedies or unduly expanded its own remedial rights."); *Disc. Fabric House of Racine, Inc. v. Wis. Tel. Co.*, 117 Wis. 2d 587, 602, 345 N.W.2d 417, 425 (1984) (quoting *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264, 268 (E.D. Mich. 1976)).

434. *See Moss, supra* note 38, at 1744.

435. *Id.*; Sandra Braunstein & Carolyn Welch, *Financial Literacy: An Overview of Practice, Research, and Policy*, 88 FED. RES. BULL. 445, 445 (2002).

436. *See Barr, supra* note 47, at 236.

437. *See Braunstein & Welch, supra* note 435, at 445 ("As knowledgeable consumers demand products that meet their short- and long-term financial needs, providers compete to create products having the characteristics that best respond to those

Several groups have already begun efforts to increase financial literacy.<sup>438</sup> Wisconsin's DFI and Governor Doyle's Council on Financial Literacy have invested in promoting financial literacy through grants and educational initiatives like the recent "Money Smart Week Wisconsin."<sup>439</sup> The Wisconsin Credit Union League sponsors financial-literacy programs for teachers in hopes of assisting them in better incorporating financial education into classrooms.<sup>440</sup> Summit Credit Union in Madison, Wisconsin pledged to contribute \$75,000 towards a financial-literacy room in a local Boys and Girls Club as part of a program to promote savings and financial literacy and to give young people an alternative to payday loans.<sup>441</sup> The America Saves program, sponsored by the Consumer Federation of America, offers financial education and low-income savings plans.<sup>442</sup> In addition to these measures, community groups, nonprofit organizations, workplaces, and faith-based groups can create their own financial-literacy programs.<sup>443</sup>

While financial education has the potential to decrease the demand for payday loans, it can be time-consuming and costly, and some scholars question its efficacy.<sup>444</sup> Educators may have difficulty reaching the victims of payday lending; and, even if they do, consumers may lack the ability to apply the lessons they learn to their lives.<sup>445</sup> Further,

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demands."); Moss, *supra* note 38, at 1744 ("If consumers knew and understood the true costs of these short-term loans, the use of such risky credit would drop dramatically.").

438. See, e.g., Barr, *supra* note 47, at 236-37; James Edward Mills, *Credit Union Commits Funds to Financial-Literacy Effort*, CAP. REGION BUS. J., Dec. 2005, at 32; Address of Carrie Templeton at the University of Wisconsin Payday Loan Forum, *supra* note 15.

439. See Press Release, Wis. Dep't. of Fin. Insts., Governor Doyle's Council on Financial Literacy Announces Nearly \$70,000 to Support Pioneering Classroom Projects Created by Wisconsin Educators (Sept. 20, 2006), [http://www.wdfi.org/newsroom/press/2006/Nearly\\$70,000SupportPioneeringClassroomProjectsCreatedWIEducators.htm](http://www.wdfi.org/newsroom/press/2006/Nearly$70,000SupportPioneeringClassroomProjectsCreatedWIEducators.htm); Money Smart Wisconsin, <http://www.moneysmartwi.org/> (last visited Jan. 29, 2007).

440. E-mail from Jim Drogue, Vice President of League Operations, Wisconsin Credit Union League, to author (Mar. 13, 2006) (on file with the Wisconsin Law Review).

441. See Mills, *supra* note 438.

442. Am. Saves, Who We Are, What We Do, <http://www.americasaves.org/> (last visited Jan. 9, 2007); Barr, *supra* note 47, at 236; Opening Remarks of Jean Ann Fox at the University of Wisconsin Payday Loan Forum, *supra* note 14.

443. See Braunstein & Welch, *supra* note 435, at 448-49.

444. See, e.g., Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law & Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1309-11 (2002); Willis, *supra* note 142, at 813.

445. See Engel & McCoy, *supra* note 442, at 1309-10.

financial education puts the burden on consumers to change.<sup>446</sup> It does not force payday lenders to stop their harmful practices or change the unequal bargaining power in payday-loan transactions.<sup>447</sup>

### C. Market Pressures

Increased competition in the small-loan market could lead to decreased prices and more options for consumers.<sup>448</sup> A 2005 study found that banks and credit unions could offer small, short-term loans at lower cost than payday lenders.<sup>449</sup> Banks and credit unions already have the infrastructure to offer such loans; they can minimize credit losses through the use of direct deposit; and they do not have to rely exclusively on the revenues from the loans because of their diverse product offerings.<sup>450</sup> In addition, banks and credit unions have greater access to capital to finance the loans.<sup>451</sup> If banks and credit unions created short-term loan products, they could offer consumers better access to credit, more reasonable terms and conditions, and the ability to create positive credit histories.<sup>452</sup> By competing with payday lenders at lower prices, banks and credit unions could lessen the demand for high-cost payday loans and force payday lenders to adopt better terms or go out of business.<sup>453</sup>

Currently, few banks and credit unions offer alternatives to payday loans.<sup>454</sup> Many do not believe that such programs would be profitable, given the loans' high-risk nature.<sup>455</sup> Bank representatives may believe that the high interest rates they would have to charge to break even on such loans would tarnish the bank's reputation in the community.<sup>456</sup> To lend money to the subprime consumer market, banks would also have to comply with stringent federal and state regulations.<sup>457</sup> Based on federal

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446. *See id.* at 1310-11. "Such reliance is nothing more than caveat emptor served up with an informational brochure or loan counseling." *Id.* at 1311.

447. *See id.* at 1311.

448. *See Bertics, supra* note 43, at 149-50 (advocating that banks compete with payday lenders).

449. *See BAIR, supra* note 44, at 28-29.

450. *See id.*

451. Bertics, *supra* note 43, at 153.

452. *See id.* at 157.

453. *See id.* at 149-51.

454. *See BAIR, supra* note 44, at 10. Some credit unions, however, are considering entering the market. *See id.*

455. *Id.*

456. *Id.*; *see Bertics, supra* note 43, at 156-57.

457. *See Bertics, supra* note 43, at 155-56. Banks offering subprime lending products must follow regulatory guidelines to ensure safety and soundness. *Id.* These

regulators' animosity towards partnerships between banks and payday lenders, many bank representatives are reluctant to enter the subprime lending market.<sup>458</sup> Regulators, however, have informally told researchers that "banks and credit unions should be encouraged to develop low-cost small-dollar products" for high-risk consumers.<sup>459</sup> Such products may help banks by improving their rating under the Community Reinvestment Act, a federal law that requires financial institutions to meet their communities' credit needs.<sup>460</sup>

Bounce-protection services also create a disincentive for banks to develop payday-loan alternatives.<sup>461</sup> Through these services, banks automatically lend consumers money when they overdraw their accounts for a fee of \$20 to \$30,<sup>462</sup> which consumers pay with their next deposit.<sup>463</sup> The APRs associated with bounce-protection services rival those of payday loans,<sup>464</sup> leading one consumer advocate to call them "payday lending done by banks."<sup>465</sup> One study suggests that banks will be reluctant to create payday-loan alternatives that would lessen the use of bounce-protection services.<sup>466</sup> "To the extent so many depository institutions are relying on bounce protection for significant fee income, they may view it as against their own interests to cannibalize profits through development of other, lower-cost forms of small dollar credit."<sup>467</sup>

Despite bank and credit-union concerns about offering small, short-term consumer loans, several institutions have created products to

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guidelines require, for example, internal evaluations and controls, contingency plans, and documentation of capital requirements. *See id.*

458. *See* BAIR, *supra* note 44, at 10.

459. *Id.*

460. *See* 12 U.S.C. § 2901(a) (2000); BAIR, *supra* note 44, at 10. Favorable Community Reinvestment Act ratings will lead to fewer evaluations. Chin, *supra* note 14, at 750.

461. *See generally* BAIR, *supra* note 44, at 10-13; Owen B. Asplundh, Note, *Bounce Protection: Payday Lending in Sheep's Clothing?*, 8 N.C. BANKING INST. 349 (2004).

462. *See* Asplundh, *supra* note 461, at 350-51. Some lenders charge \$5 per day until the consumer repays the debt. *Id.* Other lenders permit consumers to overdraw from ATMs. BAIR, *supra* note 44, at 11.

463. Asplundh, *supra* note 461, at 351.

464. *See id.*

465. *Id.* at 351-52 (quoting Alan Kline, *A Consumer Lobbying Power Turns Attention to Overdrafts*, AM. BANKER, June 6, 2003, at 1, 1 (quoting Jean Ann Fox, Dir. of Consumer Prot., Consumer Fed'n of Am)).

466. *See* BAIR, *supra* note 44, at 13.

467. *Id.*

compete with payday loans.<sup>468</sup> In 2001, the North Carolina State Employees' Credit Union (NCSECU) created the salary-advance loan (SALO),<sup>469</sup> a revolving loan of up to \$500 at an interest rate of 12% APR that is due in full on the consumer's next payday.<sup>470</sup> To obtain a SALO, consumers must be an NCSECU member with direct deposit,<sup>471</sup> and they must place 5% of each advance in a savings account as a proactive measure to prevent future borrowing.<sup>472</sup> Five years after its inception, the SALO program is now the NCSECU's most profitable loan product,<sup>473</sup> and the mandatory savings requirement generated \$10 million in new deposit funds.<sup>474</sup> Still, NCSECU members rely heavily on SALO loans; about 70% of SALO users obtain a new loan each month.<sup>475</sup> This shows that the product has replaced payday loans but has not increased financial responsibility.<sup>476</sup>

Similar initiatives are beginning to take shape in Wisconsin. The Wisconsin Credit Union League and the Filene Research Institute created the REAL<sup>477</sup> Solutions program to motivate credit unions to better serve

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468. *Id.* at 21. More than 1,000 of the nation's 9,000 credit unions have payday-loan alternatives. Sue Kirchhoff, *Breaking the Cycle of the Payday Loan "Trap,"* USA TODAY, Sept. 20, 2006, at 1B. For suggestions on how the federal government can improve competition in the payday-loan industry, see Chin, *supra* note 14, at 750-53.

469. BAIR, *supra* note 44, at 53.

470. *Id.* A \$500 loan would cost less than \$2.50. *Id.*

471. *Id.* at 53-54. The direct-deposit requirement may prevent some low-income consumers from accessing the program. Barr, *supra* note 47, at 219 ("Low-income persons are more likely to work in smaller firms and to have sporadic, part-time, and/or multiple employment, which would complicate efforts to provide for direct deposit.").

472. *Id.* at 53. Consumers can access their savings account at any time, but if they withdraw money from this account, they cannot access another SALO for six months. *Id.*

473. See Kirchhoff, *supra* note 468. "[NCSECU President Jim] Blaine has a PowerPoint presentation showing that at a 12% interest rate and 4% default rate, the SECU makes a healthy 2% on its cash advances. In reality, he says, the default rate is far less. 'We don't put that in there because people don't believe it.'" *Id.*

474. See *id.* NCSECU also offers voluntary financial education at no cost. BAIR, *supra* note 44, at 56.

475. See BAIR, *supra* note 44, at 54.

476. NCSECU officials hope that the mandatory savings requirement will decrease members' recurrent use of SALOs in the future. *Id.* at 22.

477. "REAL" stands for Relevant, Effective, Asset-building, and Loyalty-producing. Filene Research Inst., REAL Solutions: Solving the Financial Service Needs of America's Working Families (Oct. 5, 2006), <http://filene.org/publications/detail/real-solutions-solving-the-financial-service-needs-of-americas-working-families> (last visited Jan. 29, 2007).

low-income consumers.<sup>478</sup> Consequently, the Wisconsin Credit Union League provided three Wisconsin credit unions with technology to help them create small, short-term cash loans to compete with payday loans.<sup>479</sup> Under the program, consumers must be eligible to be credit-union members,<sup>480</sup> which may deter some consumers from seeking these loans.

In 2005, as part of the REAL Solutions program, Prospera Credit Union and Goodwill Industries of North Central Wisconsin created GoodMoney, a nonprofit financial-services center located in a Goodwill store in Darboy, Wisconsin.<sup>481</sup> GoodMoney offers lower-fee payday loans, check-cashing services, and financial education.<sup>482</sup> Consumers pay \$9.90 per \$100 borrowed,<sup>483</sup> and they can borrow up to 25% of their payroll check.<sup>484</sup> After a consumer's third loan, GoodMoney requires credit counseling and offers repayment plans.<sup>485</sup> GoodMoney representatives hope that the program will help consumers avoid payday loans and increase their use of traditional financial services, including savings programs.<sup>486</sup> In its first year of operation, GoodMoney made \$1 million in loans.<sup>487</sup> Brewery Credit Union in Milwaukee offers a similar program.<sup>488</sup> Both programs seek to aid consumers in joining the

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478. See E-mail from Jim Drogue, *supra* note 440; see also Paul Gores, *Credit Unions Make Move to Help Those Who Have Less*, MILWAUKEE J. SENTINEL, Oct. 20, 2004, at D1.

479. See E-mail from Jim Drogue, *supra* note 440.

480. *Id.*

481. Press Release, Prospera Credit Union & Goodwill NCW, GoodMoney: A New Model from Goodwill NCW and Prospera to Serve the Unbanked and the Financially Underserved 1 (May 11, 2005), <http://www.goodwillncw.org/GoodMoney1.pdf>; GoodMoney, <http://www.goodmoneystore.com/> (last visited Jan. 29, 2007).

482. See Press Release, Prospera Credit Union & Goodwill NCW, *supra* note 481.

483. Kirchhoff, *supra* note 468. For a fourteen-day loan, this is an APR of approximately 260%. Five dollars of the fee covers loan defaults. *Id.*

484. Ken Eiden, President, Prospera Credit Union, Address at the University of Wisconsin Payday Loan Forum (Sept. 22, 2005).

485. *Id.*; Pete Bach, *Two Organizations Team up to Offer Loans for Less*, APPLETON POST-CRESCENT (Appleton, Wis.), July 6, 2005, available at <http://www.goodwillncw.org/goodmoneypc2.htm>.

486. Gores, *supra* note 16.

487. See Kirchhoff, *supra* note 468. GoodMoney officials hope to break even. Bach, *supra* note 485.

488. See Gores, *supra* note 16.

“personal finance mainstream” and in increasing savings to break free of the debt treadmill.<sup>489</sup>

In sum, banks and credit unions should develop products and services to compete with payday lenders and create market pressure on short-term loan prices. Some programs already exist that offer consumers alternatives to payday lending;<sup>490</sup> however, the long-term viability of these programs is unclear, and it will take time for new programs to develop. Therefore, market pressures alone cannot solve the payday-loan problem.

#### D. *The Best Approach for Wisconsin*

While each of the methods described above provides limited consumer protection against some of the problems associated with payday lending, a combination of all three methods will solve Wisconsin’s payday-loan problem. Legislation is an imperfect solution because payday lenders find loopholes in even the most stringent laws.<sup>491</sup> Payday-loan legislation can be difficult to implement and enforce,<sup>492</sup> and it does not prevent the emergence of new short-term loan products.<sup>493</sup> Local actions—such as zoning ordinances and litigation—can slow the expansion of the payday-loan industry and curb its worst abuses. Nevertheless, they are piece-meal approaches that cannot address industry-wide problems like high APRs and frequent rollovers. Finally, financial education and market pressures could eliminate payday lending by lessening the demand for payday loans. Unfortunately, financial education can be costly and ineffective, and many banks and credit unions are reluctant to enter the payday-loan market without support

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489. *Id.* “‘If all we do is provide a cheaper not-for-profit alternative, that’s not good enough in my mind,’ Eiden said. ‘We’ve got to be able to change people’s lives and give them different financial futures. That’s what we’re trying to do.’” *Id.*

490. For alternatives in addition to those discussed above, see Drysdale & Keest, *supra* note 27, at 666-68.

491. *See, e.g.,* Kirchoff, *supra* note 468 (“In Oregon, some payday firms have applied to switch to a different form of charter to circumvent the new [payday-loan] law.”).

492. *See supra* notes 212-17 and accompanying text (discussing difficulties enforcing Minnesota’s payday-loan law).

493. For example, to avoid Pennsylvania’s restrictions on payday loans, Advance American Cash Advance Centers, Inc. now plans to offer an open-ended credit line. *See* Bergquist, *supra* note 305. These lines of credit, for up to \$500, require a monthly participation fee of \$149.95 and payment of either the principal owed or \$20 each month. *Id.* The interest rate on these loans is 5.98%. *Id.* For a discussion of the credit services organization model of avoiding payday-lending restrictions, see *supra* notes 261-66 and accompanying text.

from state policymakers and banking regulators.<sup>494</sup> Thus, none of these measures alone can fully protect consumers from the problems associated with payday lending.

The best solution to the payday-loan problem would include a combination of legislation, local action, and market pressures. Legislation can provide a baseline of consumer protections and offer incentives for banks and credit unions to create payday-loan alternatives and to offer financial education.<sup>495</sup> Litigation can ensure that lenders follow the law and prevent them from taking advantage of vulnerable consumers. Zoning ordinances can limit payday lenders' growth in Wisconsin communities. Financial education and market pressures can also reduce the demand for payday loans and help consumers make wise financial decisions.

By using this combination of measures, Wisconsin could also protect consumers against other products in the fringe-banking industry, such as auto-title loans.<sup>496</sup> Payday lending is a symptom of greater problems—namely, stagnant wages, the lack of affordable health insurance, and the inability of many consumers to effectively manage their money to avoid financial emergencies.<sup>497</sup> Consequently, even strong legislation that limits or bans payday loans may fail to meet its ultimate goal of consumer protection if a different fringe-banking product emerges to replace payday lending.<sup>498</sup> By combining protective legislation with other measures designed to educate consumers and provide them with alternatives to risky short-term loans, this multifaceted approach can help consumers avoid the need for fringe-banking products in general. Therefore, implementing the suggested three-part approach to the payday-loan problem would protect consumers not only from the

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494. See BAIR, *supra* note 44, at 10 (giving reasons that banks are reluctant to compete with payday lenders); Bertics, *supra* note 43, at 154-56 (discussing the regulatory restrictions on subprime lending by banks); Engels & McCoy, *supra* note 444, at 1309-11 (listing the limits of financial education).

495. See BAIR, *supra* note 44, at 9; Chin, *supra* note 14, at 750-53; *supra* Part V.A.

496. For information about auto-title lending, see AMANDA QUESTER & JEAN ANN FOX, CTR. FOR RESPONSIBLE LENDING & CONSUMER FED'N OF AM., CAR TITLE LENDING: DRIVING BORROWERS TO FINANCIAL RUIN (2005), available at [http://www.consumerfed.org/pdfs/driving\\_borrowers\\_rpt.pdf](http://www.consumerfed.org/pdfs/driving_borrowers_rpt.pdf).

497. BAIR, *supra* note 44, at 38; Telephone Interview with Jean Ann Fox, *supra* note 29.

498. See *supra* note 493 (discussing a new fringe-banking product that has emerged due to restrictions on payday lending). Even if legislation just limits payday lending and does not ban it, lenders may develop a more profitable alternative to legal payday loans. See Bertics, *supra* note 43, at 141-42 (discussing how businesses will move into more profitable markets).

dangers of payday lending, but also from the dangers of the fringe-banking industry as a whole.<sup>499</sup>

Accordingly, by using legislation, implementing community measures (such as litigation, zoning, and financial education), and applying market pressures, Wisconsin policymakers and consumer advocates can attack payday lending from all sides. This combination of approaches would lessen the payday-loan supply through zoning ordinances that limit the number of lenders in a community,<sup>500</sup> and reduce the demand for payday loans and other fringe-banking products by increasing financial education and small-loan alternatives.<sup>501</sup> It will also limit payday lending from the inside by forcing lenders to compete through consumer-friendly terms,<sup>502</sup> and from the outside by creating substantive limits through legislation and litigation.<sup>503</sup> Thus, this approach would prevent payday lenders from taking advantage of consumers by providing viable alternatives to payday lending.

## VI. CONCLUSION

Payday lending creates serious problems for many vulnerable Wisconsin consumers, and the industry's expansion will likely continue in the future. To protect consumers from abuse by payday lenders, Wisconsin should take a multifaceted approach: (1) lawmakers should pass legislation to create a minimum standard for lenders; (2) consumer groups should use zoning, litigation, and financial education to attack payday lending locally; and (3) banks and credit unions should create alternatives to payday loans. Only with a combination of these measures can Wisconsin truly protect consumers and stop payday lenders' abusive practices.

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499. For a detailed discussion of the fringe-banking industry, see generally Drysdale & Keest, *supra* note 27.

500. See Walrath, *supra* note 380; Thomas-Lynn, *supra* note 383.

501. Bertics, *supra* note 43, at 134; Moss, *supra* note 38, at 1744.

502. Johnson, *supra* note 24, at 139; Moss, *supra* note 38, at 1744.

503. See *supra* Part V.A., .B.2.