IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

BANKWEST, INC., *et al.*,
Plaintiffs,
v.

THURBERT E. BAKER,
Attorney General of the State of,
Georgia, *et al.*
Defendants.
Civil Action File
No. 1:04CV0988-MHS

COMMUNITY STATE BANK, *et al.*,
Plaintiffs,
v.

THURBERT E. BAKER,
Attorney General of the State of
Georgia, *et al.*,
Defendants.
Civil Action File
No. 1:04CV0992-JTC

FIRST BANK OF DELAWARE, *et al.,*
Plaintiffs,
v.

THURBERT E. BAKER,
Attorney General of
the State of Georgia, *et al.,*
Defendants.
Civil Action File
No. 1:04CV1028-MHS

COUNTY BANK OF REHOBOTH
BEACH, DELAWARE, *et al.,*
Plaintiffs,
v.
THURBERT E. BAKER,
Attorney General of
the State of Georgia, *et al.,*
Defendants.
Civil Action File
No. 1:04CV1061-MHS

**Brief *Amici Curiae* of AARP, Atlanta Legal Aid Society, Inc.,
Consumer Federation of America, Georgia Legal Services Program,
Georgia Watch, National Association of Consumer Advocates,
and the National Consumer Law Center in Support of Defendants**

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STATEMENT OF INTEREST

AARP, Atlanta Legal Aid Society, Inc., Consumer Federation of America (CFA), Georgia Legal Services Program, Georgia Watch, National Association of Consumer Advocates (NACA), and National Consumer Law Center (NCLC) ("*amici*") are organizations that devote a considerable amount of work to protecting consumers from exploitation in the credit marketplace, including advocacy for strong and effective state consumer protections and law enforcement. *Amici* recognize that low-income consumers, those whom mainstream lenders consider "high risk" borrowers, and those on fixed incomes often have difficulty finding credit on reasonable terms. They typically are relegated to high-cost lenders and non-traditional sources of credit where they often are subject to deceptive and unfair lending practices, such as hidden fees, exceedingly high interest rates, oppressive collection practices, and extreme default penalties. Because products in these markets, including payday loans, are particularly exploitative, the national *amici* have assisted in state legislative efforts to enact protections for borrowers, and have filed numerous *amicus curiae* briefs, often in support of state enforcement actions, urging courts to uphold these protections.

During their long histories as consumer advocates, *amici* have observed the

need for enhanced protection of consumer rights and vigilant enforcement of laws designed for this purpose. Payday loans are just one in an array of products in a burgeoning industry that targets necessitous borrowers, the very people for whose protection usury and other interest rate limits exist. Yet, the companies that make these loans historically have tried to evade these protections, initially disguising the nature of the transactions by assigning labels other than loans to avoid disclosure and other statutory requirements. Their association with national and out-of-state federally-insured banks is just the latest in a series of efforts to circumvent these statutes.

AARP is a non-partisan, non-profit organization with more than 35 million members, approximately 880,000 of whom live in Georgia. As the largest membership organization dedicated to addressing the needs and interests of people aged 50 and older, AARP is greatly concerned about unfair and deceptive financial products and services targeted at vulnerable consumers. Because older Americans are disproportionately victimized by many of these practices, AARP supports laws and policies to protect their rights in a broad range of transactions.

Due to its concerns about abuses in this market, AARP has published reports on the issues involved and measures needed to protect consumers, as well as a model payday loan law. *See, e.g.*, Sharon Hermanson & George Gaberlavage,

AARP, *The Alternative Financial Services Industry* (2001), and Elizabeth Renuart, AARP, *Payday Loans: A Model State Statute* (2000). Since 2000, the AARP Georgia State Office has opposed industry efforts to convince the legislature to legalize payday lending, actively supported the legislation plaintiffs now seek to scuttle, and applauded the legislature's willingness to enact strong protections for some of Georgia's most vulnerable consumers. In addition, AARP attorneys represent payday borrowers alleging a fraudulent, predatory scheme, *Favors v. Stewart Fin. Co.*, No. 2002-CV-55526 (Ga. Super. Ct. Fulton County filed July 9, 2002) (with Atlanta Legal Aid Society attorneys), and were counsel in class actions alleging that a payday lender's interest rates violated federal and state laws and that the lender partnered with a national bank to evade usury and other laws. *See, e.g., Purdie v. ACE Cash Express, Inc.*, CA No. 301-CV1754-L (N.D. Tex. settlement approved Dec. 11, 2003).

Atlanta Legal Aid Society, Inc. (ALAS) is a non-profit organization that has served Metropolitan Atlanta for more than 75 years, providing legal services, in civil matters, to poor and marginalized persons unable to afford or obtain representation from private attorneys. Its client constituency has continued to fall victim to payday lending scams, and ALAS legal personnel and resources often have been needed to address the legal problems of clients arising from rampant

payday lending activities. In 2004, the problems of payday lending continue to plague the ALAS client constituency in serious and sometimes tragic ways.

Consumer Federation of America (CFA) is a non-profit association organized in 1967 to advance the interests of consumers through advocacy and education. CFA's current membership is comprised of 300 national, state, and local consumer groups throughout the United States which, in turn, represent more than 50 million consumers. Recognizing the phenomenal growth and high cost of short-term consumer credit, CFA has made protecting the interests of individual consumers in this market a priority. CFA advocates on credit consumer protections and application of payment method protections to prevent fraud and provide redress, and has published a series of reports on developments in the check cashing industry and the payday loan and refund anticipation loan (RAL) sectors. *See, e.g.*, Jean Ann Fox, Consumer Fed'n of Am., *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury* (2004) [hereinafter *Unsafe and Unsound*]; Jean Ann Fox & Edmund Mierzwinski, Consumer Fed'n of Am. & U.S. Pub. Interest Research Group, *Rent-A-Bank Payday Lending – How Banks Help Payday Lenders Evade State Consumer Protections* (2001). CFA is particularly concerned that effective consumer protections and disclosure rules serve customers of fringe banks.

Georgia Legal Services Program (GLSP) is a non-profit law firm whose attorneys represent low-income Georgians outside of metropolitan Atlanta. Throughout its history, GLSP attorneys have addressed low-income Georgians' consumer concerns through education and litigation. The payday loan industry currently targets many of Georgia's most vulnerable for loans which saddle them with chronic debt. The ill effects of these loans are felt throughout the state.

Georgia Watch is a non-profit, non-partisan consumer advocacy group working statewide to educate and involve citizens in critical consumer protection issues, including the area of predatory financial practices. This year, Georgia Watch advocated on behalf of consumers at the legislature and in support of the strongest possible consumer protections against payday lending entities. Georgia Watch activists, who were victimized by payday lending abuse, testified before legislative committees about the need for greater protections against the interest rates and other illegal lending schemes utilized by the payday lending industry. In addition to state advocacy, Georgia Watch distributes research and consumer education materials about the dangers of predatory financial practices, including payday lending.

The National Association of Consumer Advocates (NACA) is a non-profit organization whose members are private and public sector attorneys, legal services

attorneys, law professors, and law students whose primary practice and areas of specialty involve the protection and representation of consumers. NACA's mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country and to serve as a voice for its members, as well as consumers, in the ongoing struggle to curb unfair and abusive business practices.

The National Consumer Law Center, Inc. (NCLC) is a non-profit corporation established in 1969 to conduct research, education, and litigation regarding significant consumer matters. One of NCLC's primary objectives is to assist attorneys in representing the interests of their low-income and elderly clients. A major focus of NCLC's work has been to increase public awareness of, and to promote protections against, high-cost loans and other forms of abusive credit extended to low-income consumers. NCLC publishes *The Cost of Credit: Regulation and Legal Challenges* (2d ed. 2000 & Supp. 2003), and *Truth in Lending* (5th ed. 2003), among its many other treatises, to assist attorneys whose clients have been victimized by unfair, fraudulent, or deceptive lending practices. In addition, NCLC has directly assisted attorneys in scores of cases brought under federal and state credit protection statutes. The Federal Trade Commission (FTC) designated NCLC as the consumer representative in proceedings that led to the

promulgation of Rules on Preservation of Consumers' Claims and Defenses, 16 C.F.R. pt. 433, and Credit Practices, 16 C.F.R. pt. 444.

Amici submit this brief in support of defendants to inform the Court about the nature of the payday loan industry to provide a context within which to view the need for the new law and to evaluate the harm to Georgia's vulnerable borrowers that will continue if plaintiffs are able to overturn the law and further their efforts to evade usury protections. A court ruling allowing the law to take effect will best serve the public interest.

ARGUMENT

I. THE FRINGE BANKING INDUSTRY EXPLOITS VULNERABLE CONSUMERS WHO MUST RELY ON STATE REGULATION.

A. The Nature of the Marketplace

In order for the Court to fully appreciate the implications of its decision, it is important to understand the nature of the market in which payday loans are made. These loans are part of an industry popularly referred to as "fringe banking" or the "alternative financial sector" (AFS). *See* Roger Swagler, et al., *The Alternative Financial Sector: An Overview*, 7 Advancing the Consumer Interest 7, 7 (1995); John R. Burton, et al., *The Alternative Financial Sector: Policy Implications for Poor Households*, 42 Consumer Interests Annual 279, 279 (1996). Fringe bankers

target low-income, working poor, and minority consumers, and those with blemished credit histories, who cannot access traditional sources of money, credit, or certain consumer goods. This has produced a two-tiered economy, known as a system of "financial apartheid" or the "second-class" marketplace, in which middle-income and affluent consumers are served by federally-insured and regulated banks, and the poor and near-poor are relegated to expensive and, in many cases, poorly regulated alternatives. *See* Lynn Drysdale & Kathleen Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. Rev. 589, 591 (2000) [hereinafter Drysdale & Keest].

While many consumers have other ways to obtain short-term, unsecured loans, such as credit cards and checking accounts with overdraft lines of credit, the poor and near-poor have difficulty accessing these sources. Coupled with the decline in the availability of small, unsecured loans from banks and finance companies, many consumers with modest incomes or impaired credit find fringe bankers their only source of this type of credit. Well aware that they are one of the few sources of quick cash for these consumers, fringe bankers argue they merely fill the gap left by traditional lenders. Even if this were a legitimate argument, and *amici* do not concede that it is, the provision of a necessary service neither justifies

the practices that harm the very consumers these lenders purport to help nor supports reducing or evading consumer protections.

A primary segment of the fringe market offers products that allow consumers to obtain a relatively small amount of cash with repayment deferred for a relatively short period, usually two weeks. The three main forms of these cash advances -- payday loans, refund anticipation loans (RALs), auto title pawns -- are extremely expensive, often imposing triple digit annual percentage rates (APRs), far in excess of state usury and small loan limits. Even in states with permissive payday loan laws, such as Ohio, the industry seems unable to comply with federal and state laws, or even the industry's own "best practices." *See* Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 Minn. L. Rev. 1, *26-98 (2002)[hereinafter *Shrewd Business*].

In addition to high APRs, fees paid for "roll overs," when the borrower cannot repay the loan, often result in finance charges that exceed the original amount borrowed, and the borrower still owes the face amount of the check. The cost implications of rollovers were illustrated in *Turner v. E-Z Check Cashing of Cookeville, TN, Inc.*, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999), in which a lender advanced $300 in return for the consumer's check for $405, which covered the $300 advance and a $105 service fee. The borrower could not afford to repay

$405 at the end of one month, and ended up paying a monthly service charge of $105 for each of the next eight months ($840) because she could not repay the original $405 debt. Another borrower wrote a post-dated check for $575, received $500, and did fifteen rollovers in seven months, each time paying $75. She thus paid $1125 just in fees for a $500 loan. *Johnson v. The Cash Store*, 68 P.3d 1099 (Wash. Ct. App. 2003).

B. The Evolution of Payday Loans Demonstrates Both Their Abusive Nature and Lenders' Ruses to Evade Interest Limits

1. Historical Background

Payday loans have direct precursors in loans made against a borrower's wages. As salaries increased to the point they covered necessities and provided a surplus to pay principal and interest on debts, "prospective salaries and wages became assets, however inchoate, against which loans could be made." Rolf Nugent, *The Loan-Shark Problem*, 8 Law & Contemp. Probs. 3, 4 (1941). The "five-for-six-boys" lent $5 at the beginning of the week, to be repaid with $6 on the borrower's next payday, one or two weeks later. *See* Drysdale & Keest, *supra*, at 618. In some instances, "salary buyers" would "buy" the borrower's next wage packet at a discount, for example, advancing $22.50 in exchange for the "sale" of a $25 paycheck two weeks later (with an APR of 311%). *Id.* at 618-19. Another

practice involved the borrower signing a bank check covering the loan principal and interest, drawn on a bank in which the borrower did not have an account. The lender said the check was "security" and would be returned to the borrower when the loan was repaid. If borrowers defaulted, the lender deposited the check and threatened to prosecute when the bank refused payment. *See* Joe B. Birkhead, *Collection Tactics of Illegal Lenders*, 8 Law & Contemp. Probs. 78, 86 (1941).

These loans were short-term, with two weeks the most common period. William H. Simpson, *Cost of Loans to Borrowers Under Unregulated Lending*, 8 Law & Contemp. Probs. 73, 73 (1941). While the interest rates on these loans were usurious, borrowers generally did not know their rights or have access to the courts, resulting in few challenges. "'The one who suffers most at the hands of high-rate lenders is the borrower, yet he is almost the only member of society who has done nothing about his plight. . . . .'" Drysdale & Keest, *supra*, at 619-20.

Financial distress forced borrowers to renew these loans despite the high cost, causing a downward spiral mirrored by today's payday borrowers. *Id.* at 620. The borrowers' dire situations led to legislation to regulate the lenders; what emerged was a legal framework that permitted a high enough return to attract legitimate businesses into the small loan market, with sufficient safeguards to prevent abuses seen among "loan sharks." *Id.* at 621. Lenders argued the

transactions involved property purchases that were not governed by usury laws, but the Uniform Small Loan Laws adopted by many states between 1916 and 1935 defined them as cash lending subject to small loan regulation. *See* John P. Caskey, *Fringe Banking: Check Cashing Outlets, Pawn Shops, and the Poor* 31-32 (1994) [hereinafter Caskey]. Every state enacted a small loan law, except Arkansas which capped interest in its Constitution. Drysdale & Keest, *supra*, at 621.

2. Contemporary Payday Lending

There has been an explosive growth in payday lending since the industry emerged in the early 1990s. *See* Scott A. Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. Banking Inst. 339, 339 (2001) [hereinafter Schaaf]. Stephens Inc., an Arkansas investment firm, recently predicted a base of 22,000 stores generating $6 billion annually in *fees alone*. Stephens Inc., *Undiscovered Companies Serving Underbanked and Unwanted Consumers*, The 3U Consumer Fin. Monthly 2 (Mar. 29, 2004). Stephens Inc. also forecast a growth of 12-18% and annual loan volume of $40 billion. *Id*.

This growth has been tied to the deregulation of the banking industry, the absence of traditional lenders in the small loan, short-term credit market, and the elimination of interest rate caps. *See* Lisa B. Moss, *Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 Ala. L. Rev.

1725, 1732 (2000) [hereinafter Moss]. Deregulation in the 1980s led banks to eliminate less profitable services, such as free checking and small balance accounts, leaving millions of low-income households with little access to free financial services. *Id.* As mainstream institutions moved out of the small loan market due to higher returns on larger loans, payday lenders filled the void. *Id.* *See also* Schaaf, *supra*, at 340-41. In addition to an increased number of stand alone payday lenders, the recent surge in the number of loans also can be attributed to the entry into the market by check cashing outlets, convenience stores, gas stations, and pawn shops, as well as offers on the Internet. *See* U.S. Pub. Interest Research Group & Consumer Fed'n of Am., *Show Me the Money! A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures* 8 (2000), *available at* http://www.pirg.org/reports/consumer/payday/showmethemoneyfinal.pdf.

Payday loans are marketed as a quick, easy way to obtain cash. Borrowers need only maintain a personal checking account, be employed for a specified period with their current employer, and show a pay stub and bank statement. Lenders do not routinely conduct credit checks or make other inquiries into the borrowers' ability to repay. A key element of these loans is an extremely high interest rate and associated costs. A recent report found typical APRs on two-

week loans ranging from 390% to 780%, often despite much lower state interest caps. *Unsafe and Unsound*, *supra*, at 2. Lenders have argued that the absolute dollar amounts are small, but these loans are expensive given their short term. Senator Joseph Lieberman (D-Conn) hosted a December 1999 payday lending forum at which he unveiled two charts which demonstrate that it is virtually impossible for an average family to repay a payday loan when it comes due. One chart showed that a family with a household income of $35,000 and typical deductions (e.g., taxes) and expenditures (e.g., food, housing, transportation) could not repay a loan as small as $168 at the end of two weeks. This underscores that payday lending is based upon an unreasonable expectation that borrowers can repay loans in two weeks, making rollovers and borrowing from one payday lender to repay another inevitable. *See* Nat'l Consumer Law Center, 18 *NCLC Reports: Consumer Credit and Usury Ed.* 13-14 (Jan./Feb. 2000).

Both of these practices result in significantly higher costs that borrowers can ill afford and create a "debt treadmill" exacerbating the borrower's financial situation. A recent study noted that "[b]ecause of the high fees and very short terms, borrowers can find themselves owing more than the amount they originally borrowed after just a few rollovers within a single year." Michael A. Stegman & Robert Faris, *Payday Lending: A Business Model that Encourages Chronic*

Borrowing, 17 Econ. Dev. Q. 8, 19 (2003) [hereinafter Stegman]. The authors conclude that "the business practices pursued by many payday loan companies can have the same wealth-depleting effect on financially fragile families as other abusive consumer credit practices." *Id.* at 25.

Similar problems result when lenders, sometimes to circumvent state restrictions on rollovers, use "back-to-back" transactions, in which borrowers pay off their first loan but must immediately take out another loan to meet their financial needs until their next payday. *See* Keith Ernst, et al., Center for Responsible Lending, *Quantifying the Economic Cost of Predatory Payday Lending* 3 (2003), *available at* http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf.[1] "[P]ayday lenders collect the vast majority of their fees from borrowers trapped in a cycle of repeated transactions. . . . This cycle (the 'debt trap') locks borrowers into revolving, high-priced short-term credit instead of meeting the need for reasonably priced, longer-term credit." *Id.* at 2. Moreover, if these loans really were meant to address a temporary need for a small amount of money "one would expect to see industry revenues driven by one-

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1/ The authors found that 91% of all payday loans were made to borrowers with five or more payday loans per year; two in three (66%) borrowers received five or more payday loans per year and nearly one in three (31%) received twelve or more per year; on average, borrowers received eight to thirteen payday loans per year. *Id.* at 2.

time or other limited-use borrowers. For borrowers taking out five, ten, or even twenty or more loans per year, payday lending functions as chronic debt, instead of helpful credit." *Id.* at 6 (footnotes omitted). *See also* Stegman, *supra*, at 25 ("despite its expanding customer base and notwithstanding industry denials, the financial performance of the payday loan industry, at least in North Carolina, is significantly enhanced by the successful conversion of more and more occasional users into chronic borrowers.").

Studies in a number of states support these findings. For example, Illinois "[c]ustomers rarely borrow a single time, in fact, repeat business is the main source of revenue. A single licensee may have a limited customer base, but if the customer regularly refinances a loan the store may be quite profitable." Ill. Dep't of Fin. Insts., *Short Term Lending Final Report* 6 (1999) (on file with AARP). The report also found an average of thirteen contracts per borrower annually from the same lender, and the average borrower remained a customer for six months. *Id.* at 26. In Indiana, the average number of renewals per borrower during a twelve-month period was ten, only 9% of borrowers had not renewed, and the total average renewal rate was 77%. *See* Ind. Dep't of Fin. Insts., *Summary of Payday Lender Examination* (2000) (on file with AARP). *See also Smith v. Short Term Loans, LLC*, No. 99 C 1288, 2001 U.S. Dist. LEXIS 1554, at * 3 (N.D. Ill. Feb. 14,

2001) (one named plaintiff received fifteen loans in a nine-month period and another received eleven in eight months). As shown earlier, frequent rollovers cause borrowers to pay fees far in excess of the original amount borrowed.

3. Lenders' Relationships With Out-of-State Banks Are Just the Latest in a History of Attempts to Evade Interest Caps

Payday lenders have devised a number of contrivances to support their assertions that usury and other laws do not apply because they are not making loans. Initially, many lenders argued they did not make loans or charge interest at all, but simply charged "fees" to cash checks. Courts uniformly rejected the pretense that payday lenders were not making loans when they delayed depositing a consumer's check in exchange for a fee. *See, e.g.*, *Turner,* 35 F. Supp. 2d 1042; *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997); *Livingston v. Fast Cash USA, Inc.*, 753 N.E.2d 572 (Ind. 2001); *White v. Check Holders, Inc*., 996 S.W.2d 496 (Ky. 1999)*; Quick Cash of Clearwater, Inc. v. State Dep't of Agric. & Cons. Servs.*, 605 So. 2d 898 (Fla. Dist. Ct. App. 1992). The U.S. Federal Reserve Board revised its Official Staff Commentary to indicate that payday loans and other transactions that involve an agreement to defer payment of a debt constitute credit under the Truth in Lending Act, 15 U.S.C. § 1601 et seq. (2004), and Regulation Z, 12 C.F.R. § 226.2(a)(14) (2004). *See* Official Staff Commentary, 12 C.F.R.

§ 226 (Supp. I, Cmt. 226.2(a)(14)-2).

As courts and regulators rejected the pretense that these transactions were not loans involving interest charges, the industry developed new schemes. In the modern equivalent of a scam used in the 1930's and 1940's by lenders trying to charge usurious interest rates, *see Willis v. Buchman*, 199 So. 886 (Ala. Ct. App.), *rev'd for mootness*, 199 So. 892 (Ala. 1940), some payday lenders labeled their loans as "catalog sales" or "gift certificates." In a typical scenario, the borrower gave the lender a post-dated check for $130. The lender agreed to hold the check for two weeks and gave the borrower $100 in cash and $30 worth of gift certificates or merchandise coupons. Borrowers who wanted to redeem the coupons or certificates had to return to the lender to place the order, at which time the lender charged additional fees. Not only would the lender not receive any add-ons if the consumer made the same purchase directly from the catalog wholesaler, but the added charges often made the merchandise unaffordable so the consumer never redeemed the coupons or certificates and the lender kept their full value as profit. *See* Moss, *supra*, at 1729-30. On the two-week $100 loan, the $30 certificates translated to an APR of 780%. *See also Upshaw v. Georgia Catalog Sales, Inc.*, 206 F.R.D. 694, 697 (M.D. Ga. 2002) (certified a class of borrowers, finding a "jury question exists on whether the certificates have any value and thus

whether the difference in the amount of the cash advance and the amount of the customer's check is usurious interest."); *Cashback Catalog Sales, Inc. v. Price*, 102 F. Supp. 2d 1375, 1380 (S.D. Ga. 2000) (finding reasonable trier of fact could conclude gift certificates are usurious interest. "If the gift certificates are practically worthless . . . it stands to reason that many of Cashback's customers will fail to redeem them. If the gift certificates go unredeemed, their face value presumably inures to Cashback and becomes a cost of the loan.").

"Cashback ads" involve the pretense that the interest paid is purchasing an ad in a publication distributed by the lender. *See Shrewd Business*, *supra*, at * 20-21. For example, a consumer who wants to borrow $100 has to pay an ad fee of $33, which lenders maintain pays for the sale of a service. The lender holds the borrower's check as a "security deposit" and "rebates" it when the consumer repays the loan two weeks later. If borrowers cannot repay the loan they must renew it by paying an additional fee to purchase another ad. In one case, after six ad purchases, the lender guaranteed no further purchases would be necessary; the APR on the "ad" loans was 860%. *See* Drysdale & Keest, *supra*, at 604. *See also Henry v. Cash Today, Inc.*, 199 F.R.D. 566, 568 (S.D. Tex. 2000) (certifying class in case alleging defendants were unlicensed lenders making high interest (more

than twice the rate permitted by Texas law) payday loans, while pretending to sell advertising in order to avoid liability for usury and TILA violations).

In response to the wholesale rejection by courts and regulators of these ruses, payday lenders, tax preparers, and others, devised the "rent-a-bank" scheme through which to market high-interest loans. By associating with an out-of-state bank, and claiming the bank is the lender, the check cashing outlet, tax preparer, etc., seeks to take advantage of the bank's ability to export its home state's interest rate and thus to evade the usury and other interest rate caps imposed in the states where they do business. *See Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.,* 439 U.S. 299 (1978). State regulators and borrowers have sought to pierce this ruse by proving that the payday vendor is the true lender, notwithstanding representations to borrowers and regulators that the bank is the lender and the appearance of the bank's name on loan documents. *See, e.g., Purdie v. ACE Cash Express, Inc.*, CA No. 301-CV1754-L (N.D. Tex. settlement approved Dec. 11, 2003); *State ex rel. Salazar, Att'y Gen. v. ACE Cash Express, Inc.*, Case No. 01CV3739 (Colo. Dist. Ct. consent decree entered May 6, 2002); *State ex rel. Cooper, Att'y Gen. v. ACE Cash Express, Inc.*, No. 02-CVS-330 (N.C.

Super. Ct. filed Jan. 14, 2002).[2] The lawsuits alleged that the payday vendor possesses all the indicia of being the lender, namely, it takes loan applications, selects credit scoring criteria, determines borrower eligibility, disburses loan proceeds, collects principal and interest, and assumes the risk of non-payment. This has been dubbed "rent-a-bank" or "rent-a-charter" lending because the bank's only real participation is to lend its name and charter to the transaction for one or two days.

C. State Laws Protect Consumers From Fringe Bankers' Exploitative Practices

Georgians benefit from strong consumer protections that enhance their economic security. The growth of the fringe banking industry, specifically targeting consumers most vulnerable to predatory practices and least able to protect themselves from abuse, warrants stronger regulation and the rejection of exploitative lenders' attempts to evade these protections. A large percentage of consumers who use fringe lenders cannot access mainstream alternatives. They may need money immediately to pay rent or repair a car to get to work. Caskey, *supra,* at 78. While many consumers have other ways to obtain short-term, unsecured loans, such as credit cards and checking accounts with overdraft lines

[2/] The court in *Goleta Nat'l Bank v. Lingerfelt*, 211 F. Supp. 2d 711 (E.D.N.C. 2002) dismissed a lawsuit to enjoin the state enforcement proceeding.

of credit, the poor and near-poor lack access to these traditional sources of credit. A recent Federal Reserve survey found that approximately one-fourth of families did not have a credit card, and that despite widespread use of credit cards for borrowing, people in the lowest income group, families headed by persons sixty-five and older, and those who are not working are among the groups for whom such use is "notably lower." Ana M. Aizcorbe, et al., *Recent Changes in U.S. Family Finances: Results from the 1998 and 2001 Survey of Consumer Finances*, Fed. Res. Bull. 24-25 (2003), *available at* http://www.federalreserve.gov/pubs/bulletin/2003/0103lead.pdf.

Fringe banking customers frequently are at a distinct disadvantage because of limited education, bargaining power, and financial desperation. A recent study found that during the preceding five years, payday borrowers were denied credit or offered less than the amount they had sought three times more often than all adults who were turned down or given less than they requested. In the same period, payday borrowers were about four times more likely than all adults to have filed for bankruptcy. Gregory Elliehausen & Edward Lawrence, Credit Research Center, *Payday Advance Credit in America: An Analysis of Customer Demand* 45, 46 (2001). Vulnerable consumers like these need special protection, a role served by usury laws and other statutes regulating fringe banking. Usury laws have, for

hundreds of years, been enforced to "protect the needy from the greedy." Drysdale & Keest, *supra*, at 657. More than a century ago, a court stated:

> "These statutes were made to protect needy and necessitous persons from the oppression of usurers and monied men, who are eager to take advantage of the distress of others; while they, on the other hand, from the pressure of their distress, are ready to come to any terms; and with their eyes open, not only break the law, but complete their ruin."

Whitworth & Yancy v. Adams, 26 Va. (5 Rand.) 333, 335 (1827) (quoting *Brown v. Morris*, Cowp. Rep. 792).

Georgia courts similarly have discussed the importance of enforcing usury laws and the need to look at substance over form to do so. For example, as long ago as 1850, the Georgia supreme court noted that among the bases for usury laws

> is, that the money holder, and in this case, the creditor, shall not avail himself of the necessitous condition of his debtor, to exact of him burdensome and oppressive terms. The law mercifully restrains both the power and the cupidity of the creditor, by limiting interest upon loans and all contracts to a fixed rate . . . and to insure against cruel exactions, makes lawful interest irrecoverable, if more is contracted to be paid.

Troutman v. Barnett, 9 Ga. 30, 33-34 (1850).

Many years later, the court stated that from the earliest history of the Georgia usury law it "has strongly denounced any artifice by which a lender,

taking advantage of the distress and necessities of a borrower, has sought to evade or violate the provisions of Georgia law upon this subject." *Bank of Lumpkin v. Farmers State Bank*, 161 Ga. 801, 809, 132 S.E. 221, 224 (1926). *See also West v. Dorsey*, 248 Ga. 790, 792, 285 S.E.2d 703, 705 (1982) (noting "an historical aversion to usury."); *Schneider v. Phelps*, 359 N.E.2d 1361, 1365 (N.Y. 1977) ("The purpose of usury laws, from time immemorial, has been to protect desperately poor people from the consequences of their own desperation. Law-making authorities in almost all civilizations have recognized that the crush of financial burdens causes people to agree to almost any conditions of the lender and to consent to even the most improvident loans. Lenders, with the money, have all the leverage; borrowers, in dire need of money, have none.").

Consumer protection laws reflect that the consumer credit marketplace lacks equal bargaining power, equal knowledge, and a level playing field with respect to negotiating leverage. *See, e.g., In re Jordan*, 91 B.R. 673, 688 (Bankr. E.D. Pa. 1988) ("It is not surprising that interested, sophisticated lenders consistently interpret ambiguous laws to their own advantage and to the disadvantage of their obviously less-sophisticated customers. This data only highlights [sic] the need of the disinterested courts to be vigilant to prevent industry-wide overreaching."). These inequalities are more pronounced in the fringe banking market than in the

mainstream consumer credit market, and consumers who resort to these products are among those with the greatest need for a marketplace that operates with integrity and the enforcement of laws that state legislatures passed for their protection. Fringe lenders should not be able to evade the usury, small loan, and other interest rate limits that states have designed to protect necessitous consumers from these exploitative practices.

CONCLUSION

Amici respectfully urge the Court to deny plaintiffs' request for declaratory and injunctive relief and to protect the public interest by allowing the new law to take effect.

Date: April 22, 2004

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type style requirements of LR 5.1B because this brief has been prepared in a proportionally spaced typeface using WordPerfect 10 in 14 Point type, Times New Roman.

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Dated: April 22, 2004