BORROWING FROM PETER TO PAY PAUL: A STATISTICAL ANALYSIS OF COLORADO'S DEFERRED DEPOSIT LOAN ACT

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ABSTRACT

On July 1, 2000, Colorado's Deferred Deposit Loan Act (DDLA) became effective. This law regulates a small, short-term, high-cost form of consumer loan commonly called a "payday" loan. With the DDLA's enactment, the office of the Administrator of the Uniform Consumer Credit Code, the state agency with regulatory oversight of the payday loan industry in Colorado, began collecting and studying data from Colorado payday lenders concerning their loans and the consumers who obtain them. This article reports on the results of that study. It (1) briefly explains payday loan mechanics and its origins; (2) discusses the advent of modern payday lending, including initial regulation and the events surrounding the DDLA's enactment; (3) examines the growth of and changes in the payday lending industry in Colorado; (4) turns to the study itself, including statistical analyses of consumer demographics, loan terms and finance charges, and consumers' utilization of payday loans and relationship of such utilization to lenders' revenues; and (5) offers some suggested changes to the DDLA.

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INTRODUCTION

On April 18, 2000, Colorado Gov. Bill Owens signed into law Senate Bill (SB) 00-144, the Deferred Deposit Loan Act (DDLA). This act, codified as Article 3.1 of Colorado's Uniform Consumer Credit Code, §§ 5-1-101, *et seq*., C.R.S. 2004 (Code), regulates a small, short-term, high-cost form of consumer loan called a "deferred deposit loan"[1], also commonly called a "postdated check" or "payday" loan.[2]

Since the DDLA's enactment, the office of the Administrator of the Uniform Consumer Credit Code[3] has been collecting and studying data from Colorado payday lenders concerning their loans and the consumers who obtain them. This article reports on the results of that study, representing the first four and one-half years of experience under the DDLA. From this, it is hoped that policy makers, regulators, and others can determine whether the DDLA is fulfilling its purposes and meeting Colorado consumers' needs.

I first present a brief primer on the mechanics of payday lending (Part I) and its history (Part II). I then discuss the advent of modern payday lending in Colorado and initial attempts to regulate it (Part III), providing the historical context for the Code's 2000 revision and passage of SB 00-144 (Part IV). After examining the growth of and changes in the payday lending industry in Colorado (Part V), I turn to the Administrator's study (Part VI). I explain the study and its methodology and then present its results. These results include statistical analyses of consumer demographics, loan terms and finance charges, and consumers' utilization of payday loans and relationship of such utilization to lenders' revenues. Finally, based on my observations from these results, I offer some

1. COLO. REV. STAT. § 5-3.1-102(3) (2005).

2. *See*, *e.g.*, Creola Johnson, *Payday Loans: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 9, 9 n.34 (2002); JEAN ANN FOX, THE GROWTH OF LEGAL LOAN SHARKING: A REPORT ON THE PAYDAY LOAN INDUSTRY 1 (1998), http://www.consumerfed.org/pdfs/The_Growth_of_Legal_Loan_Sharking_1998.pdf (listing various names for payday loans).

3. The Administrator is the administrative agency vested with regulatory authority to enforce compliance with the Code, including the DDLA. *See*, *e.g.*, COLO. REV. STAT. § 5-6-104 (2005). *See generally* COLO. REV. STAT. §§ 5-6-101 to -116 (2005). The Administrator is appointed by the Attorney General and the agency is created and exists within the Department of Law. *See* COLO. REV. STAT. § 5-6-103 (2005).

suggested changes to the DDLA to correct deficiencies arising from its current structure (Part VII).

I. A BRIEF PRIMER ON PAYDAY LENDING

First, what, exactly, is a payday loan? This type of loan is a small, single-advance, single-payment, short-term, and high-cost loan. As described by the Federal Reserve Board, a payday loan is a credit transaction

> in which a cash advance is made to a consumer in exchange for the consumer's personal check, or in exchange for the consumer's authorization to debit the consumer's deposit account, and where the parties agree either that the check will not be cashed or deposited, or that the consumer's deposit account will not be debited, until a designated future date.[4]

The DDLA similarly defines a "deferred deposit loan" as a consumer loan in which the lender advances money to the borrower and in return accepts from the consumer an "instrument," such as a check or authorization to debit the consumer's bank account, in the amount of the advance plus allowable finance charges.[5] The lender agrees not to cash the check or debit the account for the term of the loan.[6]

The DDLA limits the principal amount of the loan to no more than $500.[7] The term of the loan may not exceed forty days.[8] The DDLA allows the lender to charge a maximum finance charge of up to 20% of the first $300 of principal, and up to 7.5% of any principal amount in excess of $300.[9] Thus, the maximum allowable DDLA finance charge for a maximum loan amount of $500 is $75. The "cost" of a typical $300, two-week loan with a DDLA finance charge of $60, expressed as an "annual percentage rate" (APR), is slightly over 520%.[10] *See* Table 1.

At the end of the loan's term, i.e., when repayment of the loan, including both principal and finance charge, is due, the consumer may pay

4. 12 C.F.R. pt. 226, supp. I § 226.2(a)(14)(2) (2005). 12 C.F.R. pt. 226 is Federal Reserve Board Regulation Z (Reg. Z), the primary regulation implementing the Truth in Lending Act (TILA), 15 U.S.C. §§ 1601-1677 (2005). *See* 12 C.F.R. § 226.1(a) (2005). Supplement I to Reg. Z is the Federal Reserve Board's Official Staff Commentary (OSC), which is the vehicle by which the Federal Reserve Board's staff issues interpretations of TILA and Reg. Z. *See* 12 C.F.R. pt. 226, supp. I § 1 (2005) [hereinafter Supplement I].

5. *See* COLO. REV. STAT. § 5-3.1-102(3), (4) (2005) (defining "deferred deposit loan" and "instrument," respectively).

6. *See* COLO. REV. STAT. §§ 5-3.1-102(3)(b), 103 (2005).

7. *See* COLO. REV. STAT. § 5-3.1-106(1) (2005).

8. *See* COLO. REV. STAT. § 5-3.1-103 (2005).

9. *See* COLO. REV. STAT. § 5-3.1-105 (2005).

10. The DDLA requires the same loan disclosures as is required with any other consumer loan under the Code, TILA, and Reg. Z. *See* COLO. REV. STAT. § 5-3.1-103 (2005).

Table 1: The "Cost" of a Typical Two-Week Loan (*Based Upon a Fourteen-Day Loan Term)

Amount Financed ($)	Maximum Allowable Finance Charge ($)	APR (%)*
100	20	521.43
200	40	521.43
300	60	521.43
400	67.5	439.96
500	75	391.07

this amount to the lender and redeem the instrument, or the lender may negotiate the instrument.[11]

Alternatively, the consumer may "renew" the loan for an additional period of time by paying another DDLA finance charge.[12] Typically, both the finance charge for and loan term of the renewed loan are the same as with the original loan. For example, let us take a fourteen-day, $300 loan with a $60 finance charge. On day fourteen – the loan's due date - the lender typically will allow the consumer to renew the loan for an additional fourteen days by paying the $60 finance charge, with another $60 finance charge due at the end of the second fourteen-day term.

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11. *See* COLO. REV. STAT. §§ 5-3.1-103, 108(3), 111 (2005). For other descriptions of payday loan mechanics, see, for example, *Ex parte* Speedee Cash of Ala., Inc., 806 So. 2d 389, 390 (Ala. 2001) (describing payday loans as loans where, in return for a cash advance, the borrower gives a check to the lender in the amount of the advance plus an additional charge, and the lender agrees not to deposit the check until some later date, at which time either the borrower may redeem the check by paying its face amount or the lender presents the check for payment). *See also* 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, 1258 (2001); Lisa Blaylock Moss, *Modern Day Loan Sharking: Deferred Presentment Transactions & the Need for Regulation*, 51 ALA. L. REV. 1725, 1728–30 (2000); 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, 600–605 (2000); Scott A. Schaaf, *From Checks to Cash: The Regulation of the Payday Lending Industry*, 5 N.C. BANKING INST. 339, 341–342 (2001); ELIZABETH RENUART & KATHLEEN E. KEEST, THE COST OF CREDIT: REGULATION, PREEMPTION, AND INDUSTRY ABUSES § 7.5.5 (3d ed. 2005); FOX, *supra* note 2, at 1–2.

12. *See* COLO. REV. STAT. § 5-3.1-108(2) (2005). "Renewals" are also commonly called "rollovers" or "refinances." *See, e.g.*, Schaaf, *supra* note 11, at 342 (using the term "rollovers"); LAURA E. UDIS, REPORT OF THE UNIFORM CONSUMER CREDIT CODE REVISION COMMITTEE AND ACTIONS OF THE COLORADO COMMISSION ON CONSUMER CREDIT 23–24 (1999) [hereinafter REPORT OF THE UCCC] (using the term "refinances"). However, the term "rollover" also refers to the practice, discussed *infra* Part VI.E, whereby a consumer pays cash to pay off a loan in full on its due date, but then immediately receives a new loan, typically for the same amount and for a similar term. *See also* COLO. REV. STAT. § 5-3.1-108(3) (2005) (indicating that once the consumer completes the transaction by paying off the first loan, the consumer may enter into a new loan). Although not a true "renewal" in the DDLA refinance sense of the term, the net economic effect to the consumer of this latter type of "rollover" is the same as a renewal – for the net payment of the first loan's finance charge, the consumer extends the payment of the principal amount for another term. *See infra* Part VI.E. So as to avoid confusion, I limit my use of the term "renewal" to its statutory definition in COLO. REV. STAT. § 5-3.1-108; I use the term "rollover" to refer generically to loan "extensions" in manners other than true DDLA renewals.

Then, on day twenty-eight, the renewed loan's due date, the consumer may pay the loan off in full by paying $360, i.e., the $300 principal plus the second $60 finance charge.

The DDLA prohibits a lender from renewing a payday loan at the high DDLA finance charge rate more than once.[13] At the end of the renewal term, either (1) the consumer must pay the loan in full (whether by paying cash to redeem the instrument or through the lender's negotiating the instrument)[14]; or (2) the lender may refinance the loan as a regular supervised loan under the Code at rates applicable to such loans.[15]

Although the DDLA limits to one the number of renewals, it does not contain any limits as to the number of times a lender may "rollover"[16] the loan by extending a new loan to the consumer immediately after the consumer pays off the prior loan. To illustrate using the prior example, on day twenty-eight, the consumer pays off the renewed loan by paying the lender $360. Immediately, the lender extends to the consumer a new $300, fourteen-day loan, with a $60 finance charge. These types of "rollover" transactions are variously called "touch and go," "back-to-back," "same-day advance," "same day buy-backs," or "same day as payoff."[17]

II. A BRIEF HISTORY OF PAYDAY LENDING

Payday lending is not new. Rather, it is merely a recent incarnation of a form of credit transaction that has existed for over a hundred years. Its roots are directly traceable to the "wage assignment," "salary buying," or "salary lending" transactions of the late nineteenth and early twentieth centuries.[18] In these types of transactions, a lender would "buy" at a dis-

13. *See* COLO. REV. STAT. § 5-3.1-108(1) (2005).

14. *See* COLO. REV. STAT. § 5-3.1-108(3) (2005).

15. *See* COLO. REV. STAT. § 5-3.1-108(4) (2005). A "supervised loan" is a consumer loan with an APR in excess of 12%. *See* COLO. REV. STAT. § 5-1-301(47) (2005). The Code generally limits non-DDLA supervised loan interest rates to no more than 36% APR, but allows alternative finance charges for certain small installment loans. *See* COLO. REV. STAT. §§ 5-2-201(2), 214 (2005).

16. *See supra* note 12 (describing "rollovers").

17. *See, e.g.*, Drysdale & Keest, *supra* note 11, at 601 (discussing "touch and go" transactions); JEAN ANN FOX & EDMUND MIERZWINSKI, RENT-A-BANK PAYDAY LENDING: HOW BANKS HELP PAYDAY LENDERS EVADE STATE CONSUMER PROTECTIONS 15 (2001), http://www.consumerfed.org/pdfs/paydayreport.pdf (discussing "touch and go" transactions); Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 156 (2004) (discussing "same-day advance" transactions); KEITH ERNST ET AL., QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 3–4 (2003), http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy 121803.pdf (discussing "back-to-back" transactions).

18. *See* Drysdale & Keest, *supra* note 11, at 618–20 (describing wage assignment transactions); RENUART & KEEST, *supra* note 11, § 2.5, at 39, § 7.5.5.1, at 292 (observing that the market for small, short-term loans has come full circle from turn-of-the-century "salary lenders" to present-day payday lenders). *See also* Bruch, *supra* note 11, at 1267–68, 1270 (tracing history of payday loans); Moss, *supra* note 11, at 1731 (describing payday lending as a "modern day version of consumer abuses practiced at the beginning of the Twentieth Century"). A recent paper traces payday lending's roots to several thousand years ago. *See* Steven M. Graves & Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of "Payday" Loans in Military*

count the borrower's next expected wage payment. For example, a lender would pay a borrower $20 in return for receiving the borrower's $24 wage payment due two weeks later.[19] Lenders claimed that these types of transactions were not loans and therefore not subject to applicable usury laws.[20] However, the courts had no trouble piercing the lenders' veils of form and routinely held these transactions were loans and the lenders' schemes merely devices to conceal usury.[21]

III. THE EMERGENCE OF PAYDAY LENDING IN COLORADO AND EARLY REGULATION

Modern payday lending emerged in the early 1990s.[22] In Colorado, it commenced formally in June 1992. Some time prior to then, the Administrator became aware of what were then being called "deferred presentment" check cashing transactions.[23] Check cashers, who typically cash third-party checks for consumers for a fee,[24] started offering to consumers a different type of "check cashing" transaction. In these transactions, the check casher advanced money to the consumer in exchange for receiving the consumer's personal check in the amount of the advance plus an additional sum. Often, the consumer's check was post-dated; regardless, the check casher agreed to defer presentment of the check for a period of time, typically two weeks, after the advance. In Administrative Interpretation No. 3.104-9201,[25] the Administrator concluded that

Towns, 66 OHIO ST. L.J. (forthcoming 2005) (manuscript at 14–15, *available at* http://www.law.ufl.edu/faculty/publications/pdf/peterson_military.pdf).

19. *See* Drysdale & Keest, *supra* note 11, at 618–19 (describing "5 for 6 boys" and similar schemes); Bruch, *supra* note 11, at 1267–68; RENUART & KEEST, *supra* note 11, § 2.2.3.1, at 15.

20. *See* Bruch, *supra* note 11, at 1267–68.

21. *See, e.g.*, Gibbs-Hargrave Shoe Co. v. Peek, 103 So. 672, 673–74 (Ala. 1925) (finding that the purchase and assignment of wages was a loan subject to small loan law); Hinton v. Mack Purchasing Co., 155 S.E. 78, 80 (Ga. Ct. App. 1930) (indicated that wage assignment was a cover for a usurious loan); Jackson v. Bloodworth, 152 S.E. 289, 291 (Ga. Ct. App. 1930) (holding that the "sale" of $20 for $24 in wages payable in two weeks was a usurious loan); State *ex rel.* Smith v. McMahon, 280 P. 906, 908 (Kan. 1929) (finding that assignments of wages were usurious loans); Martin v. Pac. Mills, 158 S.E. 831, 832 (S.C. 1931) (finding that the sale of wages was a usurious loan). *See also* Pub. Fin. Corp. of Lynchburg v. Londeree, 106 S.E.2d 760, 767 (Va. 1959) (noting that the enactment of small loan laws was to eliminate the "evil of salary buying and other extortionate schemes"). The Code expressly prohibits "wage assignments" and deems these transactions loans. *See* COLO. REV. STAT. § 5-3-206 (2005). Recently, the Colorado Supreme Court held that a similar type of transaction, involving the purported "purchase and assignment" at a discount of anticipated income tax refunds, was a disguised usurious loan subject to the Code. *See* Colorado *ex rel.* Salazar v. Cash Now Store, Inc., 31 P.3d 161, 163–64, 167 (Colo. 2001).

22. *See, e.g.*, Bruch, *supra* note 11, at 1270; Schaaf, *supra* note 11, at 339. *See also* Barr, *supra* note 17, at 149, 149 n.109 (noting few occurrences of the term "payday loan" prior to 1994 in a search of a Nexis database).

23. *See* Administrative Interpretation NO. 3.104-9201, 1–2 (June 23, 1992) (Adm'r Colo. Uniform Consumer Credit Code) (on file with Office of the Colo. Att'y Gen.) [hereinafter Admin. Interpretation NO. 3.104-9201].

24. Colorado does not regulate check cashing. *See id.* at 1 (indicating that the Uniform Consumer Credit Code ("Code") applies to "check cashing transactions" only if the transaction involves an extension of credit).

25. *Id.*

these transactions were extensions of credit governed by the Code.[26] She held that the Code's minimum finance charge provision, which allowed a lender to charge a finance charge of no more than $25 regardless of the resulting APR,[27] applied to these transactions.[28] However, she further concluded that, if the transaction's resultant APR exceeded 12%, then the check casher must be licensed as a supervised lender and must comply with the Code's other provisions, such as those regulating loan disclosures.[29] Thus officially began modern payday lending in Colorado.[30]

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26. *Id.* at 1–2.

27. *See* 1981 Colo. Sess. Laws 391. The enactment of the DDLA made the Code's minimum finance charge provision inapplicable to payday loans. *See* COLO. REV. STAT. §§ 5-2-201(7), 5-3.1-108(4) (2005).

28. Admin. Interpretation No. 3.104-9201, *supra* note 23, at 4. Notably, the Indiana Supreme Court held that, under Indiana's version of the Uniform Consumer Credit Code, the Indiana Code's "minimum finance charge" provision did not allow payday lending. *See* Livingston v. Fast Cash USA, Inc., 753 N.E.2d 572, 576–77 (Ind. 2001). Indiana's version is significantly different from Colorado's; the Indiana version omits the word "notwithstanding." *Compare* COLO. REV. STAT. § 5-2-201(7) ("Notwithstanding the provisions of subsections (1), (2), and (3) of this section . . . .") *with* IND. CODE ANN. § 24-4.5-3-508(7) (2005) (omitting the "notwithstanding" phrase).

29. Admin. Interpretation NO. 3.104-9201, *supra* note 23, at 4–6.

30. Admin. Interpretation No. 3.104-9201 reflects a theme commonly seen in some lenders' challenges to payday lending regulation - the disguising of the transaction as something other than a loan so as to avoid application of usury and other consumer credit protection laws. While a thorough discussion of the many artifices that have been used to disguise payday loans is beyond the scope of this article, I present a brief synopsis.

Similar to what the Administrator faced, initially some payday lenders claimed their transactions were non-credit, deferred "check cashing" transactions, with the fees merely "check cashing" fees and not "finance" charges. The two seminal cases rejecting these claims are *Hamilton v. York*, 987 F. Supp. 953 (E.D. Ky. 1997), and *Turner v. E-Z Check Cashing of Cookeville, Tennessee, Inc.*, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999). *See Hamilton*, 987 F. Supp at 955–58; *Turner*, F. Supp. 2d at 1047–49, 1052. Both courts applied basic "substance over form" maxims of usury jurisprudence to hold that "deferred presentment" check cashing transactions were loans subject to TILA and state usury laws. *See id.* In a Mar. 2000 amendment to the OSC, the Federal Reserve Board removed any doubt that such deferred "check cashing" transactions are credit transactions under TILA. *See* 65 Fed. Reg. 17,129 (Mar. 31, 2000) (publishing Supplement I § 226.2(a)(14)-2). Significantly, the Federal Reserve Board emphasized that the amendment did "not represent a change in the law." 65 Fed. Reg. at 17,130.

Other devices used to disguise payday loans include (1) making the loan under the guise of the "sale" of an item, such as catalog merchandise, *see, e.g.*, Cashback Catalog Sales, Inc. v. Price, 102 F. Supp. 2d 1375, 1376 (S.D. Ga. 2000), Austin v. Alabama Check Cashers Ass'n, Nos. 1011907 & 1011930, 2005 WL 3082884, at *2 (Ala. Nov. 18, 2005); advertisements, *see, e.g.*, Henry v. Cash Today, Inc., 199 F.R.D. 566, 568 (S.D. Tex. 2000); merchandise or gift certificates, *see, e.g.*, New York *ex rel.* Spitzer v. JAG NY, LLC, 794 N.Y.S.2d 488, 489 (App. Div. 2005); Internet service or access contracts, *see, e.g.*, Short on Cash.Net of New Castle, Inc. v. Dep't of Fin. Insts., 811 N.E.2d 819, 821 (Ind. Ct. App. 2004); North Carolina *ex rel.* Cooper v. NCCS Loans, Inc., No. COA04-1660, 2005 WL 2848029 (N.C. Ct. App. Nov. 1, 2005); pre-paid telephone cards, *see, e.g.*, *Austin*, 2005 WL 3082884, at *6, JAG GA, LLC v. Oxendine, No. 2004-CV-3197-6 (Ga. Super. Ct. May 5, 2005) (judgment affirming administrative cease and desist order); and so-called "sale/leaseback" transactions, *see, e.g.*, Indus. Loan Comm'r v. Edwards Fin. Servs., Inc., No. 1998CV02055 (Ga. Super. Ct. Oct. 14, 2002) (granting summary judgment); *see also* SAL Leasing, Inc. v. State *ex rel.* Napolitano, 10 P.3d 1221, 1224–26 (Ariz. Ct. App. 2000) (holding that the sale/leaseback transaction was a disguised car loan). *See generally* Johnson, *supra* note 2, at 18–21; Drysdale & Keest, *supra* note 11, at 604, 643–44; RENUART & KEEST, *supra* note 11, §§ 7.5.5.4–.6.

Another method used by some payday lenders to circumvent state usury or other consumer credit laws is to partner with a national bank or other federally-insured depository institution. FOX & MIERZWINSKI, *supra* note 17, at 15. In these so-called "rent-a-bank" arrangements, no pretense is made as to whether the transaction is a loan. *See id.* (indicating that the "typical payday loan-bank arrangement involves *loans* made over the counter at the non-bank company's location")

As is seen, it was the Code's "minimum finance charge" provision[31] that allowed the lawful birth of payday lending in Colorado. Applying this provision to authorize these types of transactions was, perhaps, an unintended consequence of the provision, unforeseen at the time of the Code's original enactment in 1971.[32]

Accordingly, because payday lending did not exist (at least, not legally) when the Code was first enacted, the Code's requirements were unsuited for many of the issues peculiar to payday loans. For example,

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(emphasis added). Instead, the payday lenders claim that the *banks* are the true lenders of the loan and that they act merely as *agents* for the banks. *See id.* at 15–16. Since, the argument goes, the *banks* are the true lenders, the *banks* may preempt local state usury laws under the interest rate exportation powers, *see id.*, provided by, for example, the Federal Deposit Insurance Act, 12 U.S.C. § 1831d (2000), or National Bank Act, 12 U.S.C. § 85 (2000), *see, e.g.*, Smiley v. Citibank (S.D.), N.A., 517 U.S. 735, 737–41, 747 (1996); Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp., 439 U.S. 299, 313–15 (1978). Thus, the payday lenders/"agents" argue the loan is not subject to state usury limits or other state payday loan laws. *See* FOX & MIERZWINSKI, *supra* note 17, at 15–16. To date, with one exception the courts have rejected the "rent-a-bank" device. Instead, they have held that whether or not the bank is the true lender, or merely a straw man inserted into the transaction to circumvent state consumer credit law, is an issue analyzed under traditional "substance over form" usury jurisprudence. *See, e.g.*, Bankwest, Inc. v. Baker, 324 F. Supp. 2d 1333, 1346–1351 (N.D. Ga. 2004) (rejecting a preemption challenge against a state law prohibiting non-bank payday lenders from partnering with banks and using the "rent-a-bank" device where the non-bank payday lender was the "de facto" lender), *aff'd*, 411 F.3d 1289 (11th Cir. 2005); Goleta Nat'l Bank v. Lingerfelt, 211 F. Supp. 2d 711, 717–18 (E.D.N.C. 2002) (noting that whether a non-bank payday lender, who partnered with a national bank, was the "de facto" lender was a sharp factual dispute and such a finding would preclude the non-bank from relying upon the federal preemption/exportation powers applicable to the bank); Colorado *ex rel.* Salazar v. ACE Cash Express, Inc., 188 F. Supp. 2d 1282, 1284–85 (D. Colo. 2002) (holding that a non-bank payday lender agent of national bank could not rely upon National Bank Act to remove to federal court the state's regulatory action against it). *But see* Hudson v. ACE Cash Express, Inc., No. IP 01-1336-C H/S, 2002 WL 1205060, at *4, 6–7 (S.D. Ind. 2002) (expressly eschewing the "substance over form" analysis and relying on loan documents to hold that bank was the true lender, thus preempting plaintiff's state law usury claims against the non-bank payday lender agent). *See generally* FOX & MIERZWINSKI, *supra* note 17, at 14–20; Barr, *supra* note 17, at 150–51; Johnson, *supra* note 2, at 105–16; RENUART & KEEST, *supra* note 11, §§ 3.13, 7.5.5.7.

Similar to the Georgia law involved in *Bankwest*, *supra*, and in part to combat the "rent-a-bank" device, the DDLA regulates not just the "true" lender, but also the lender's agent or other arranger of the loan. *See* COLO. REV. STAT. § 5-3.1-102(5)(a) (2005). Thus, all payday loans made using a non-bank agent or arranger must comply with the DDLA's substantive provisions, regardless of whether or not the "true" lender is a bank or similar federally insured depository institution. For example, at issue in *Salazar*, *supra*, was whether the DDLA's licensing requirement and one-renewal limit applied to a non-bank agent of a national bank and the loans made through the agent. *See Salazar*, 188 F.Supp. 2d at 1284. As part of a settlement reached in the case, the non-bank agent agreed to become licensed and refund $1.3 million in excess finance charges by reason of violating the one-renewal limit. *See* Colorado *ex rel.* Salazar v. ACE Cash Express, Inc., No. 01CV3739 (Denver Dist. Ct. May 6, 2002) (entering consent decree); RENUART & KEEST, *supra* note 11, § 3.13.2, at 116 n.740. In regulating not just the "true" lender but also the lender's agent/arranger and all loans made through the agent/arranger, the DDLA is similar to other "loan arranger" statutes, such as those in Maryland and Massachusetts. *See* FOX & MIERZWINSKI, *supra* note 17, at 21-22.

Expectedly, most payday loan law circumvention devices occur in states whose legal environment is hostile to payday lending. *See* BankWest, Inc. v. Oxendine, 598 S.E.2d 343, 348 (Ga. Ct. App. 2004), *reconsideration denied*, (Apr. 6, 2004), *cert. denied*, (Sept. 7, 2004) (observing that a non-bank agent used the "rent-a-bank" arrangement only in states where payday lending was illegal).

31. *See supra* note 27 and accompanying text.

32. *See* 1971 Colo. Sess. Laws 770–852 (enacting Uniform Consumer Credit Code). *See also Livingston*, 753 N.E.2d at 576–77 (indicating that the Uniform Consumer Credit Code did not anticipate short term payday loans).

the Code did not regulate (1) maximum or minimum payday loan amounts; (2) the numbers of payday loans a consumer could have outstanding with one lender at any one time; (3) the imposition, besides the finance charge, of other charges or fees that might be permitted under the Code, such as deferral or delinquency charges; and (4) a payday lender's charging the consumer a check cashing fee where the lender paid the loan proceeds in the form of a check to the consumer. There was concern among various stakeholders, including policy makers, industry members, and others, that the nature of payday lending required more regulation than the Code then provided.[33]

A matter of particular concern involved "loan splitting." As mentioned, the then-Code's minimum finance charge provision allowed a lender to charge a minimum finance charge of $25, regardless of the resultant APR.[34] Relying upon this provision, some payday lenders quickly saw an opportunity to increase the finance charges they collected by engaging in the practice of "loan splitting."[35] This practice involved a lender making multiple, smaller payday loans to a consumer in place of one larger loan in order to multiply the finance charges. For example, rather than make a single $200 loan to a consumer and charge one allowable $25 finance charge, a lender would make two separate $100 loans and charge two $25 finance charges – one for each loan - and double its revenue.[36]

Although the then-Code prohibited "loan splitting" "for the purpose of obtaining a higher finance charge than would otherwise be permitted,"[37] because the provision spoke in terms of "purpose," there were perceived difficulties in enforcing this provision in the case of payday lending.[38] For example, a payday lender might argue that the "purpose"

33. *See generally* Rule 7 Official Record (on file with Office of the Colo. Att'y Gen. pursuant to COLO. REV. STAT. § 24-4-103(8.1) (2005)).

34. *See supra* note 27 and accompanying text.

35. *See* Administrative Interpretation NO. 3.409-9601, 1 (Aug. 5, 1996) (Adm'r Colo. Uniform Consumer Credit Code) (on file with Office of the Colo. Att'y Gen.) [hereinafter Admin. Interpretation NO. 3.409-9601].

36. *See id.*; Bellizan v. Easy Money of La., Inc., No. Civ.A. 00-2949, 2002 WL 1066750, at *3, 9–10 (E.D. La. May 29, 2002) (payday lender engaged in "loan splitting" by splitting one loan into smaller ones), *vacated in part on reconsideration*, 2002 WL 1611648 (E.D. La. July 19, 2002). "Loan splitting" may take many forms. For example, in *In Re* First American Cash Advance, LLC (Adm'r Colo. Uniform Consumer Credit Code Dec. 15, 2003) (assurance of discontinuance), the Administrator resolved issues of a payday lender's "loan splitting" where the lender did not allow spouses to obtain one large joint loan, but instead required them to obtain two smaller loans, one to each spouse individually.

37. 1975 Colo. Sess. Laws 247 (amending § 5-3-409, now codified at COLO. REV. STAT. § 5-3-205 (2005)). *See also* Admin. Interpretation No. 3.104-9201, *supra* note 23, at 5 (applying Code's "loan splitting" prohibition to payday lending). I use the more descriptive "loan splitting" rather than the Code's "multiple agreement" terminology.

38. *See* Admin. Interpretation No. 3.409-9601, *supra* note 35, at 1–2 (observing that a "loan splitting" violation may depend upon lender's "purpose and intent," itself a fact specific inquiry). *But cf. Bellizan*, 2002 WL 1066750, at *9–10 (holding that payday lender's practice of "loan splitting" violated state law's "multiple agreements" prohibition without inquiring into subjective "purpose").

of splitting loans was *not* to obtain a higher total finance charge, but to increase the collectability of the loans. That is, by holding two smaller instruments from the consumer instead of one larger one, a lender might claim it increased the probability that, upon the loans' maturity, at least one of the instruments would clear the consumer's bank. Thus, a payday lender might attempt to circumvent the Code's "loan splitting" prohibition.

To address the "loan splitting" issue and some of the other Code deficiencies vis-à-vis payday lending, in 1993 the Administrator promulgated Uniform Consumer Credit Code Rule 7.[39] Essentially, Rule 7 created a rebuttable presumption in the lender's favor that, so long as the lender met a number of express conditions prescribed in the Rule, it could make and have outstanding at any one time with a consumer up to two payday loans – i.e., engage in limited "loan splitting" – without running afoul of the Code's "loan splitting" prohibition.[40] Among these conditions were that the lender, "or any person related to such lender by common ownership or control, or in whom such lender has any financial interest," could not (1) charge a finance charge greater than the lesser of (a) 25% of the face amount of the consumer's post-dated check, or (b) $25; (2) exceed an aggregate amount of $500 for the two outstanding payday loans; (3) refinance or repay a payday loan with the proceeds of another payday loan; (4) impose any other charges permitted under the Code in connection with a payday loan other than the loan's finance charge; and (5) charge a check cashing fee if it issued the loan proceeds in the form of a check.[41]

Although Rule 7 helped to alleviate some of the deficiencies in, and provided both needed guidance to the industry and additional consumer protections absent from the Code,[42] from its outset it was more or less a "stop-gap" measure. As some said during the Rule's rulemaking hearings, what was needed was a statutory "fix."[43] Further, Rule 7 proved difficult in its application, requiring the Administrator several years later to issue a clarifying interpretation.[44] Compounded by the significant rise in the number of payday lenders over the latter half of the decade,[45] it

39. *See* 4 COLO. CODE REGS. § 902-1 (1993). *See Notice of Rulemaking, Proposed Regulations, and Attorney General Opinions*, COLO. REG., Jan. 10, 1993, at 16-42 to -43. *See also* Admin. Interpretation No. 3.409-9601, *supra* note 35, at 1–5. Rule 7 was repealed with the DDLA's enactment*.* *See* 4 CODE COLO. REGS. § 902-1 (2000).

40. *See* 4 COLO. CODE REGS. § 902-1 (1993); Admin. Interpretation No. 3.409-9601, *supra* note 35, at 1–2.

41. 4 COLO. CODE REGS. § 902-1 (1993) (Rule 7 repealed Nov. 1, 2000).

42. *Id.* ("Statement of Basis, Purpose, and Statutory Authority").

43. *See* Summary of the Rulemaking Hearing for Multiple Agreements and Post Dated Checks 1–2 (Feb. 3, 1993); Notes on the Council of Advisors on Consumer Credit Meeting 2–3 (Dec. 11, 1992). Both of these documents are part of the Rule 7 Official Record (on file with Office of the Colo. Att'y Gen.).

44. *See* Admin. Interpretation No. 3.409-9601, *supra* note 35, at 2–5.

45. *See infra*, Part V.

became apparent that neither Rule 7 nor the Code adequately provided the necessary structure desired by payday lenders, consumers, and regulators.

IV. THE CODE'S 2000 REVISION AND ENACTMENT OF THE DDLA

At a February 1, 1999, meeting of the Commission on Consumer Credit,[46] while discussing a bill to deregulate the Code, the Commission unanimously passed a motion to rewrite the Code completely during the General Assembly's 2000 session.[47] Subsequently, the Attorney General ordered the creation of the Uniform Consumer Credit Code Revision Committee (Committee).[48] The Committee's mandate was to make recommendations for and draft legislation rewriting the Code, taking "due consideration for, and balanc[ing]," the protection of consumers from "financially detrimental or unfair" transactions on one hand, and legitimate and scrupulous creditors from "unnecessary governmental regulation" that puts them at a "competitive disadvantage" on the other.[49] As stated by the Attorney General, the impetuses for this wholesale rewrite of the Code were the "technological developments, the widespread and rapid availability of credit, and the development of creative and new credit practices since 1971 when the [Code was first adopted] . . . ."[50] This included such practices as payday lending.

The Committee consisted inter alia of representatives of both creditor and consumer interests.[51] As part of its mandate, it specifically considered and addressed payday lending.[52] During its consideration of payday lending issues, the Committee expanded its membership to include representatives of the payday lending industry.[53]

The discussion of payday lending issues itself required several Committee meetings.[54] The Committee considered such things as "loan splitting," posting of fees, the applicability of civil bad check penalty laws, permissible finance charges, and limits on renewals.[55] Although the Committee could not reach consensus on some critical payday lending issues, such as the maximum allowable finance charge or numbers of renewals (if any),[56] it unanimously agreed that a comprehensive payday

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46. The Commission, created by 1971 Colo. Sess. Laws 850 (enacting § 73-6-401, later renumbered as § 5-6-401), was the "policy-making body for purposes of implementing" the Code. *Id.* The General Assembly dissolved the Commission in the Code's 2000 revision.

47. *See* REPORT OF THE UCCC, *supra* note 12, at 2; Minutes of Meeting, Commission on Consumer Credit, Feb. 1, 1999 (on file with Office of the Colo. Att'y Gen.).

48. *See* Att'y Gen. Admin. Order 1999-4 (Colo. Att'y Gen. Apr. 27, 1999).

49. *Id.*

50. *Id.*

51. *See* REPORT OF THE UCCC, *supra* note 12, at 3, 29.

52. *Id.* at 3, 20-25.

53. *Id.* at 3, 29.

54. *Id.* at 3.

55. *Id.* at 21-25.

56. *Id.* at 22-24.

loan law should be incorporated as a single article of a revised Code.[57] The Committee finished its work in November 1999; its efforts resulted in a proposed comprehensive revised Code draft, including a fully-integrated article regulating payday loans.[58]

Meanwhile, during the summer of 1999, the American Legislative Exchange Council (ALEC) sponsored a conference for, and attended by, state legislators from a number of states, including Colorado.[59] At this conference, representatives of the payday lending industry pitched an industry model payday loan law they hoped the attendees would take back to their respective state legislatures.[60] As a result of this conference, the industry model bill was brought back to Colorado to be introduced in the upcoming 2000 legislative session.

At this time, the Colorado legislative sponsors of the proposed bill apparently were unaware of the Committee or its mandate; in particular, they were unaware of the Committee's efforts to craft payday loan legislation. Unlike the Committee's proposal, the industry model bill was a stand-alone law.[61] Although contemplated as a separate part of the Code, it made no references to the Code and did not include such basic provisions as licensing, regulation, or examination, by an agency with regulatory and compliance oversight, of payday lenders.

Before the proposed industry bill was introduced, in late December 1999 (after the Committee's work had finished) one of the bill's sponsors contacted the Administrator to advise her of the planned bill.[62] Thus aware of two potentially competing payday loan bills in the same legislative session, the Attorney General's office (the prime mover behind the Committee's effort), decided to eliminate the payday loan provisions from the Committee's contemplated Code revision.[63] Instead, it worked with the sponsors and the legislative drafting office to conform the industry bill into something that would comport with the revised Code and payday loan regulation, as the Committee had envisioned it.[64] However, much like trying to fit a square peg into a round hole, the initial draft of

57. *Id.* at 21.

58. *See* Draft Colorado Uniform Consumer Credit Code, §§ 5-2-401 to 5-2-409 *in* Appendix, REPORT OF THE UCCC (on file with Office of the Colo. Att'y Gen.) [hereinafter *Draft U.C.C.C.*].

59. ALEC's goals are "[t]o promote the principles of federalism by developing and promoting polices that reflect the Jeffersonian principles" of government and "[t]o enlist state legislators from all parties . . . who share ALEC's mission." Am. Legis. Exchange Couns., Mission Statement, http://www.alec.org/about/mission-statement.html (last visited Nov. 10, 2005).

60. *See, e.g,* Show Me the Money: A Survey of Payday Lenders and Review of Payday Lender Lobbying in State Legislatures, http://uspirg.org/reports/paydayloans2000/showmethemoney final.PDF (showing that the payday loan industry has actively lobbied state legislatures for laws it deems favorable).

61. *See* Office of Legislative Legal Services, Colorado General Assembly, LLS 00-0610.01 (initial draft of the "Deferred Presentment Services Act," Dec. 20, 1999; this draft would have created a new Part 7 to Title 5, Article 3 of the Code) (on file with Office of the Colo. Att'y Gen.).

62. Author's personal recollections.

63. *Id.*

64. *Id.*

the industry bill required major surgery to make it fit within the proposed revised Code.[65]

The end result of these efforts was the introduction of two separate bills: House Bill (HB) 00-1185, the culmination of the Committee's work to revise comprehensively the Code, but without any payday loan provisions; and SB 00-144, the separate payday loan bill, which upon enactment would be a part of the revised Code.[66] However, and despite the many changes, both pre- and post-introduction, to SB 00-144 to integrate it into the Code, the result was not as perfect a fit as would have been had the Committee's comprehensive revision instead been adopted.[67]

One particularly contentious issue concerned the maximum allowable finance charge. As originally introduced, SB 00-144 provided for a finance charge of 20% of the amount financed.[68] While the industry supported this figure, consumer advocates and others sought a lower figure.[69] The 20% figure survived the bill's debate in the Senate.[70] However, the House Business Affairs and Labor Committee subsequently amended the bill to lower the maximum finance charge to 15%.[71] This figure was amended again, despite substantial dissent, during the bill's second reading debate on the House floor to the finally enacted version providing a "step" rate finance charge.[72] This compromise incorporated the industry's 20% finance charge rate for loans of $300 or less, and a marginal rate of 7.5% for the next $200 in principal, yielding a total maximum allowable finance charge rate of 15% for loan amounts of the maximum allowable $500.[73] Significantly, the Commission, al-

65. *See supra*, *Draft U.C.C.C.* note 58.

66. HB 00-1185, 62d General Assembly, 2d Sess. (Colo. 2000) (repealing and reenacting the Code in its entirety); SB 00-144, 62d General Assembly, 2d Sess. (Colo. 2000) (creating and adding the DDLA as a new article to the Code.).

67. For example, the DDLA contains some perhaps superfluous repetition that did not exist in the Committee's draft, *e.g.*, COLO. REV. STAT. § 5-3.1-115 (2005) (requiring same record keeping and annual reporting as in COLO. REV. STAT. § 5-2-304 (2005)); COLO. REV. STAT. § 5-3.1-116 (2005) (requiring same licensure requirements as in COLO. REV. STAT. §§ 5-2-301 & 5-2-302 (2005)); COLO. REV. STAT. § 5-3.1-117 (2005) (providing for same compliance examinations and investigations as in COLO. REV. STAT. § 5-2-305 (2005)). Additionally, whereas the Committee's draft bill would have built upon Rule 7's loan splitting protections by specifically defining "lender" to include any and all affiliates thereof, *see Draft U.C.C.C.*, *supra* note 58 (§ 5-2-401(2), 5-2-401(3)), SB 00-144 did not.

68. SB 00-144, 62d General Assembly, 2d Sess. (Colo. 2000).

69. *See generally* Hearings on SB 00-144 Before the Senate Business Affairs and Labor Committee, 62d General Assembly, 2d Sess. (Jan. 31, 2000).

70. *See* Colo. S. Jour., 62d General Assembly, 2d Sess., at 197 (Feb. 1, 2000) (committee report); *id.* at 268 (Feb. 11, 2000) (2d reading); *id.* at 299-300 (Feb. 14, 2000) (3d reading).

71. Colo. H. Jour., 62d General Assembly, 2d Sess., at 877-78 (Colo. Mar. 10, 2000) (committee report) [hereinafter House Journal]. *See generally* Hearings on SB 00-144 Before the House Business Affairs and Labor Committee, 62d General Assembly 2d Sess. (Mar. 7, 2000).

72. *See* House Journal, *supra* note 71, at 1142-43 (Mar. 29, 2000) (2d reading amendment); *id.*, at 1146-47 (attempt to override amendment); *see generally* Hearings on SB 00-144 Before the House Committee of the Whole (Mar. 29, 2000).

73. *See* COLO. REV. STAT. 5-3.1-105 (2005).

though it could not reach consensus on an appropriate finance charge figure, did not advocate a "step" rate.[74]

Ultimately, both bills became law, and the revised Code, including the incorporated DDLA, became effective July 1, 2000.[75]

V. THE GROWTH OF PAYDAY LENDING IN COLORADO[76]

Over the last decade, Colorado has experienced a dramatic growth in payday lending. This growth has occurred both in terms of (1) the numbers of licensed lenders and their locations, and (2) total loan volume.

As of January 1, 1997, Colorado had 177 licensed payday loan locations. Over the next several years, growth was steady, but modest; as of July 1, 2000, there were 212 licensed locations. Since July 1, 2000, the effective date of the DDLA, growth has been nothing short of explosive. As of January 1, 2005, there were 616 licensed payday loan locations in Colorado. Further, over 80% of these locations obtained their licenses after July 1, 2000. *See* Figure 1.

Mirroring the growth in numbers of payday lender locations, the increase in total payday loan volume has been no less explosive. Total payday loan volume for 1996 was $34 million. The next several years saw steady growth, with total loan volume for 2000 of $106 million. However, in 2001, the first full calendar year after the enactment of the DDLA, volume jumped to $180 million; it has been mushrooming ever since, totaling $368 million for 2004, the last full year for which data is available.[77] *See* Figure 2.

With this growth has come a change in the industry's complexion. Up until the DDLA, most Colorado payday loan locations were stand-alone, independent, and locally-owned "mom and pop" operations. However, since the DDLA's enactment the industry has undergone a major consolidation. A number of national, out-of-state corporations

74. REPORT OF THE UCCC, *supra* note 12, at 22-23.

75. *See* 2000 Colo. Sess. Laws 1257 (most provisions of the revised Code); *id.* at 444 (DDLA).

76. The data and figures reported in this section are derived principally from the Administrator's Deferred Deposit Lenders Supervised Lenders' Annual Reports for the respective years, or other records maintained by and publicly available from the Administrator. COLO. REV. STAT. § 5-2-304(2) requires every supervised lender (including payday lenders, *see* COLO. REV. STAT. § 5-3.1-115 (2005)) to file annual reports with the Administrator. The Administrator then prepares a composite report consolidating the data received from the individual lenders' reports. The Administrator does not audit or otherwise verify the information submitted by the individual lenders before including it in her composite annual report.

77. Although an exploration of the reasons for the growth in payday lending is beyond the scope of this article, a number of theories have been advanced, including (1) the deregulation of the banking industry, (2) the absence of traditional small loan providers, and (3) the elimination of interest rate caps. *See generally* Moss, *supra*, note 11 at 1732-33; Schaaf, *supra*, note 11, at 340-41. No doubt, at least part of the growth since 2000 must be attributed to the friendly regulatory environment created by the DDLA.

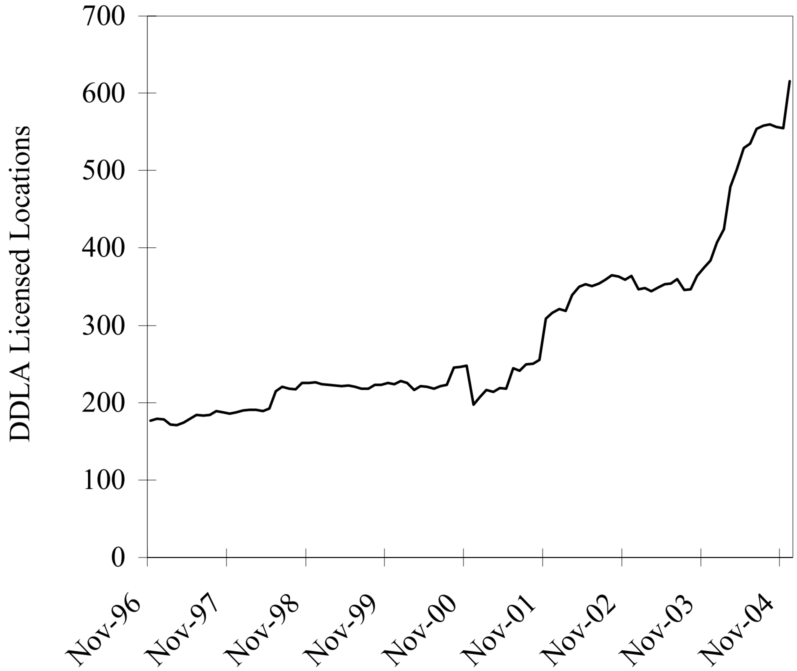

Figure 1: Licensed payday loan locations.

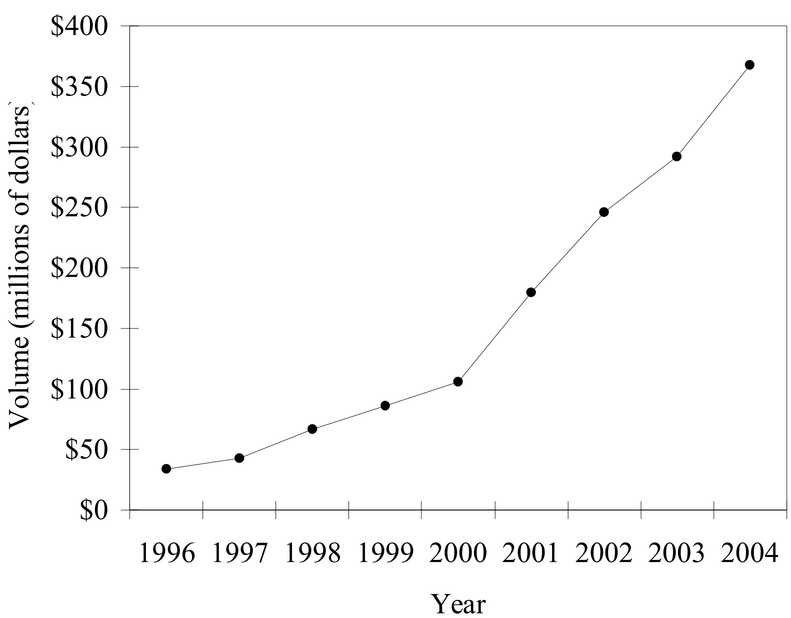

Figure 2: Total annual payday loan volume.

Table 2: The Ten Largest DDLA Licensees[78] (as of Dec. 31, 2004)

Licensee	# of Licenses
ACE Cash Express, Inc.	81
Advance America Cash Advance Centers of Colorado, LLC	58
BN'T Loans, LLC	91
Check Into Cash of Colorado, Inc.	34
Monetary Management of California, Inc.	26
EZPawn Colorado, Inc.	25
Allied Cash Advance Colorado LLC	21
Valued Services of Colorado, LLC	20
Pawn One, Inc.	16
Checkmate of Colorado, Inc.	14
All Others	230
Total	616

78. ACE Cash Express, Inc., d/b/a ACE America's Cash Express, is a Texas corporation with principal offices in Irving, Texas. It obtained its first licenses in Oct. 1992. By July 1, 2000, it operated approximately 51 licensed locations. Although it subsequently cancelled its licenses, resulting in the "rent-a-bank" litigation discussed *supra*, note 30, it reapplied for and received 53 new licenses, effective Nov. 2001. The number of ACE licenses in Table 2 does not include independently-owned ACE franchise locations.

Advance America Cash Advance Centers of Colorado, LLC, d/b/a Advance America, is a Delaware company with principal offices in Spartanburg, South Carolina. It obtained its first Colorado license in June 1998 and, since July 1, 2000, has added 37 licensed locations.

BN'T Loans, LLC, is a Missouri corporation located in Springfield, Missouri. It opened its first Colorado location in Feb. 2004. In Dec. 2004, the agent for BN'T, The Cigarette Store Corp., d/b/a Smoker Friendly, d/b/a Gasamat, through whom BN'T made loans, obtained 45 licenses for 45 locations in which it acted as BN'T agent. The figures in Table 2 includes the 45 licenses held by BN'T's agent; BN'T itself had 46 licenses. Both BN'T and its agent cancelled their licenses in Feb. 2005. This resulted in a drop of only a few points in the percentage of licenses held by the ten largest licensees.

Check Into Cash of Colorado, Inc., d/b/a Check Into Cash, is a Colorado corporation with principal offices in Cleveland, Tennessee. It opened its first location in Nov. 2000.

Monetary Management of California, Inc., d/b/a Loan Mart, is a California corporation located in Berwyn, Pennsylvania. It first became licensed in Colorado in Sept. 2000. It is a subsidiary of Dollar Financial Group, Inc., which in turn is a subsidiary of Dollar Financial Corp., a publicly-traded company incorporated in Delaware with principal offices in Berwyn, Pennsylvania.

EZPawn Colorado, Inc., d/b/a EZMoney Payday Loans, is a Delaware corporation based in Austin, Texas. It obtained its first Colorado license in June 2001.

Allied Cash Advance Colorado LLC, d/b/a Allied Cash Advance, is a Delaware company with principal offices in Miami, Florida. It opened its first Colorado location in May 2003.

Valued Services of Colorado, LLC, d/b/a First American Cash Advance, is a Georgia company based in Chattanooga, Tennessee. It obtained its licenses in May 2004, due to a change in ownership of its predecessor entity, First American Cash Advance of Colorado, LLC. The predecessor entity was a Tennessee company located in Cleveland, Tennessee, and first became licensed in Colorado in Dec. 2000.

Pawn One, Inc., d/b/a Jumping Jack Cash, a Colorado corporation based in Westminster, Colorado, is the only local company in the top ten. It obtained its current licenses beginning in January 2004 (between Apr. 1997 and Jan. 1998, it briefly held a single license).

Checkmate of Colorado, Inc., d/b/a Checkmate Payday Loans and Check Cashing, is a Nevada corporation with principal offices in Carlsbad, California. It opened its first Colorado licensed location in Aug. 2003.

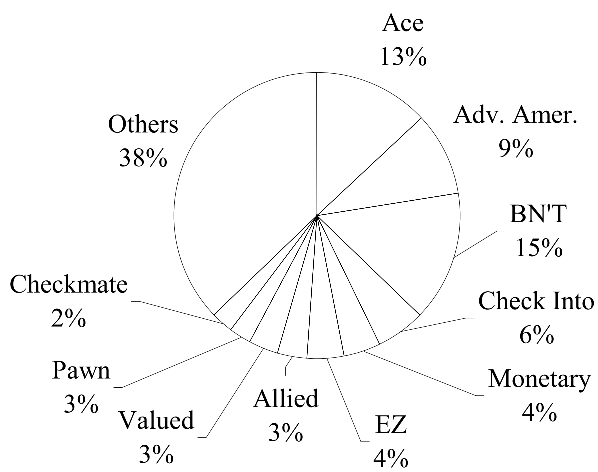

Figure 3: Ten largest DDLA licensees (as of Dec. 31, 2004).

either began doing business or expanded their operations in Colorado to such an extent that they now dominate the market. As of December 31, 2004, the ten largest licensees accounted for nearly 63% (62.66%) of all licensed locations, with the remaining licensed locations scattered among some 109 separate, small sole proprietorships or companies.[79] *See* Table 2 and Figure 3.

VI. THE STUDY, ITS METHODOLOGY OF DATA COLLECTION, AND ITS RESULTS

A. The Databases and Data Collection Methodology

In July 2000, as part of their regular compliance examinations,[80] the Administrator's staff began collecting various data from payday lenders concerning their loans. This was done in part to provide insight into payday lenders' lending practices and their consumers' borrowing habits,

79. This data seems to contradict the industry's position that payday loan outlets are "really small businesses, not part of a [sic] enormous national industry scheme." Schaaf, *supra*, note 11, at 349.

80. Pursuant to COLO. REV. STAT. § 5-2-305 (2005), the Administrator is authorized to conduct periodic compliance examinations of supervised lenders. These compliance examinations entail reviewing the lender's "loans, business, and records". *Id.* COLO. REV. STAT. § 5-3.1-117 (2005) makes this compliance examination authority specifically applicable to payday lenders. This latter section is another example of a DDLA "duplicative" provision that a comprehensive Code revision, as envisioned by the Committee, likely would have eliminated. *See supra*, note 67.

and thus facilitate a study and evaluation of the DDLA's efficacy. Among the categories of loan data collected were: (1) the terms of the loans being written, including the amount financed, the finance charge, and the length of the loan; (2) whether, and how often, the loans were renewed or "rolled over"; and (3) individual consumer borrowing information, such as how many loans a particular consumer obtained or had outstanding with a particular lender over the previous twelve month period.

Additionally, beginning in July 2001, the staff started collecting consumer demographic information. The staff culled this information from the consumers' loan applications and income verification information obtained by the lenders at the time of the consumer's first loan from the lender. Among the demographic data collected were the consumer's (1) age, (2) gender, (3) marital status, (4) monthly income, (5) job classification (e.g., professional, managerial, laborer, etc.), and (6) length of time at current employment.

The staff recognized that the validity of any analysis of the data collected depended upon the sampling from which the data was taken – that is, the sample should be random. Accordingly, to assure randomness, for loan data collection the staff selected for study a particular lender's thirty most recent loan transactions preceding the date of that lender's compliance examination. It is from these thirty loan transactions, and their respective consumers' loan histories, that the examiners gathered information concerning loan terms, renewals, and the consumers' borrowing histories. The examiners gathered the same information from each set of thirty most recent loans from whatever lender they happened to examine. Thus, the database should not be skewed in any manner, such as by favoring loans made (1) on particular dates or times of month, (2) by specific lenders or in particular geographic locations, or (3) to particular consumer groups (e.g., age, gender, marital status, and the like).

Similar to the methodology used in collecting loan data, to assure randomness in consumer demographic data the examiners selected for study those consumers who applied for and obtained their first loan with the lender being examined within the thirty days preceding the date of the compliance examination. For manageability purposes, the examiners limited the size of the sample of consumers per compliance examination to thirty. That is, if more than thirty consumers obtained first loans from the lender within the previous thirty days, then the sample was limited to the most recent thirty consumers. In practice, because few lenders had more than thirty new consumers in any thirty-day period, the examiners rarely used this limitation.

The Administrator's staff continues to collect both loan and consumer demographic data as part of their regular payday lender compliance examinations. Accordingly, the databases are growing daily. However, for purposes of this article I use a database cut-off date of December 31, 2004. As of this date, the Administrator's staff had amassed loan data from over 22,000 separate loan transactions obtained during some 760 separate compliance examinations of 402 separate licensed payday lender locations. Similarly, as of this date the consumer demographic database consisted of over 10,000 separate entries collected during the course of over 680 compliance examinations.[81]

Both databases can be analyzed from a variety of temporal perspectives, such as calculating averages over the databases' entire lives or from one particular point in time to another. In this way, the databases can be used to discern trends over time in payday lending under the DDLA. Most of the statistics in this paper are based on analyses of the entire databases from their inception through the December 31, 2004, cut-off. Whenever a statistic is based upon a particular temporal subset of the databases, such as to spot trends, I so state.[82]

B. Consumer Demographics

The "average" Colorado payday loan borrower is a thirty-six year-old single woman, making $2,370 per month, employed as a laborer or office worker and in her current job for about three and one-half years. More specifically:

• The average age of a payday loan borrower is just over 35.8 years old, with the average age between men and women nearly identical. Borrowers are skewed towards the younger age groups, with almost two-thirds – 62.41% - of all borrowers falling between the ages of twenty to thirty-nine years old. Those 55 years or older comprise 7.42% of all borrowers, and those sixty-five years or older only 1.67%.

• Women make up more than half of all borrowers, 54.99% to 45.01% for men.

• Single borrowers outnumber married borrowers, 52.67% to 47.33%.

• The average borrower has worked at his or her current job for 3.49 years (3.57 years for men and 3.43 for women). However, nearly a quarter – 22.07% - of all borrowers were employed at their current jobs for less than six months.

81. The databases, appropriately redacted to remove any specific consumer or lender identifying information, are available for public study upon request to the Administrator or Colorado Attorney General's office.

82. Because not all lenders obtain identical consumer demographic information on their loan applications, the sample size of this database varies depending upon the particular category of datum. Further, where data in a particular category was not available from a particular lender, this was not factored into the database. Accordingly, where averages are derived from the data, they are done so only from samples where data was obtained.

• The average monthly gross income for all borrowers is $2,373 ($2,606 for men and $2,186 for women). Consumers earning less than $2,500 per month comprised nearly two-thirds – 62.88% - of all borrowers, and the median monthly gross income is $2,170.

The data also reveals a nearly inverse relationship between the borrower's occupational category and monthly income, on one hand, and the numbers of borrowers within that category, on the other. As shown by Table 3, the majority of all borrowers – 62.80% - occupy the lowest three income categories. Very few payday loan borrowers – from the database sample, only twenty, or 0.24% – are "professionals," such as doctors, lawyers, dentists, and the like, with average incomes in excess of $50,000.[83]

C. *Average Loan Terms*

The "average" payday loan has the following characteristics:

• The average amount financed, or loan principal, is $285.36. This figure has crept up slightly over time; for example, the average loan amount during the 2003 calendar year was $283.20, and for 2004 was $308.16.

• The average finance charge is $50.87. Here, too, the trend for this figure seems to be on the rise; in 2003, the average finance charge was $51.22, and in 2004 was $53.84.

• The average loan term is 16.63 days. However, slightly over 60% (60.34%) of all loans are for fourteen days or less. These figures have held fairly steady over time.

83. The study's consumer demographic data contrasts somewhat with that touted by the industry. *See*, *e.g.*, Schaaf, *supra*, note 11, at 348-49 (citing industry sources that claim the average annual income is $33,000, with length of current employment at 4 years); *see also*, Community Financial Services Association of America, Payday Advance Customer Profile, http://www.cfsa.net/govrelat/pdf/Payday Advance Customer Profile.pdf (citing statistics showing 77% of borrowers have incomes greater than $25,000, with 25% greater than $50,000); Freedom of Choice for Consumers: The Truth About Deferred Deposit Services – A Reasoned Response to the CFA's Misrepresentations, http://www.fisca.org/ddresponse.htm. (claiming average consumer has income from $20,000 to $25,000 on the low side and $35,000 to $45,000 on the high side) [hereinafter Freedom of Choice for Consumers]. CFSA and FiSCA are the two leading national payday lending trade associations. *See* Welcome to CFSA, http://www.cfsa.net ("CFSA is the only national membership trade association [of the] Deferred Presentment industry", representing "approximately two-thirds of this market"); Quick Facts About FiSCA, http://www.fisca.org/qa.htm ("FiSCA is a national trade association that represents 5,000 neighborhood financial service centers); *see also* Motion of Financial Service Centers of America, Inc. for Leave to File Brief as *Amicus Curiae* at 1, Colorado *ex rel.* Salazar v. ACE Cash Express, Inc., 188 F. Supp. 2d 1282 (D. Colo. 2002) (No. 01-D-1576) (FiSCA is the "largest voluntary trade association in the payday-loan industry"). At least one commentator suggests the industry's data "should be treated with caution." Barr, *supra*, note 17, at 153 n.135. And, while military personnel represent less than 5% of all payday loan borrowers, a recent paper suggests payday lenders disproportionately target military bases, including those in Colorado, in which to set up shop and market their services. *See* Graves & Petersen, *supra*, note 18 at 93-97, 178-79.

Table 3: Consumer Occupations

Occupation	Average Income ($)	% of Consumers
Professional	4,852	0.24
Managerial	3,872	3.66
Government	3,160	6.51
Agricultural	2,811	0.08
Education	2,758	2.93
Military	2,620	4.26
Sales	2,571	4.00
Healthcare	2,552	7.20
Other	2,468	8.32
Laborer	2,213	30.25
Office	2,209	23.79
Benefits Recipient	1,358	8.76

- Based on these averages, the average payday loan has an APR of 391.34%. There does not seem to be any particular trend for this figure; in 2003, the average APR was 398.76%, and in 2004 it was 381.56%.

Some statistics appear to be attributable directly to the DDLA's peculiar two-tiered "step" rate finance charge limits. As previously mentioned,[84] the DDLA allows a maximum finance charge of 20% of the first $300 of loan principal and 7.5% of the next $200 of principal, up to a maximum loan amount of $500. Accordingly, the most profitable payday loans, in terms of maximum allowable finance charges, are those written for $300 or less. Above $300, the marginal rate of return diminishes significantly. *See supra* Table 1.

Not surprisingly, therefore, almost three-quarters – 72.93% - of all payday loans are written for loan amounts of $300 or less. Indeed, the most frequent single loan amount is exactly $300, accounting for nearly a third – 29.92% - of all payday loans.

The DDLA's "step" rate system leads to potential problems. First, as the data indicates these rates may encourage some lenders to "steer" consumers to loans of $300 or less.

A more serious problem involves "loan splitting."[85] That is, some lenders may require consumers, who may want a single, large loan above the $300 threshold, to obtain two smaller loans under the $300 tier and thereby realize a total finance charge in excess of what would be allowable with the single, large loan.

84. *See supra*, Part I.
85. *See supra* text accompanying notes 35-36.

As discussed previously,[86] "loan splitting" was a problem that existed under the pre-DDLA Code, in response to which the Administrator promulgated Rule 7. However, rather than advance Rule 7's attempt to combat "loan splitting," the DDLA's "step" rate structure statutorily creates an incentive for some lenders to engage in "loan splitting." Thus, the DDLA seemingly brings the Code full circle back to its pre-Rule 7 days.

D. Finance Charge Rates and Competition – The "Race to the Bottom"

The payday loan industry in part justifies the high finance charges and triple-digit interest rates associated with payday loans based on the "huge" risks incurred with such loans; one industry paper pegs these risks "typically at least seven to 10 times greater than banks are willing to accept."[87] However, payday lenders' loss rate experience, as reported to the Administrator by the lenders themselves, refutes this claim.

Specifically, for the years 1996 through 2004, payday lenders report an average charge-off rate, or loss experience, of 3.34% of their total loan volume.[88] This loss rate compares favorably to commercial banks' charge-off rates on consumer loans, as reported by the Federal Reserve Board. For the same period, the charge-off rate for *all* consumer loans made at commercial banks was 2.69%; for credit cards, it was 5.15%.[89]

The study also controverts the industry's claims of the role competitive market forces play in determining finance charges. That is, a major payday lending trade association has claimed that payday loan fees are "set by competitive forces in the market."[90] However, the data does not support this claim. Rather, competition among payday lenders appears to

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86. *See id.*

87. Freedom of Choice for Consumers, *supra*, note 83; *see also Schaaf*, *supra*, note 11 at 349 (noting industry claims that rates are "proportional to the risk undertaken.").

88. *See* Annual Reports described *supra*, note 76. As part of their annual reports, payday lenders are required to report their total volume of loans charged off. The loss experience is expressed as the ratio of total charge-offs to total loan volume. The charge-off ratio ranged from a low of 2.28% in 2000 to a high of 4.14% in 2004. These figures are consistent with data reported elsewhere. *See*, *e.g.*, RENUART & KEEST, *supra*, note 11 § 7.5.5.2, at 294-95 (5.4% and 1.7% charge off rates for two publicly-traded payday lenders); *see also* Bruch, *supra*, note 11, at 1279 n.243 (comparing payday lending charge-off rates with those of check cashers). Another publicly-traded payday lender, Dollar Financial Corp., reported net charge-offs of 2.0% and 2.1% in its quarterly results for the quarters ending June 30 and Sept. 30, 2005, respectively. *See* Press Release, Dollar Financial Corp. Announces Fiscal Fourth Quarter and Year End Results; Strong International Revenue Growth of 25.5% and Total Revenue Growth of 21.5% Drive Results (Aug. 23, 2005), http://www.dfg.com (follow "Investor Relations" hyperlink); Press Release, Dollar Financial Corp., Dollar Financial Corp. Announces 2006 Fiscal First Quarter Results; Growth of 12.6% Drives Growth in Net Income (Oct. 27, 2005), http://www.dfg.com (follow "Investor Relations" hyperlink).

89. *See* Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks, http://www.federalreserve.gov/releases/chargeoff/chgallsa.htm (seasonally adjusted).

90. Freedom of Choice for Consumers, *supra*, note 83. This paper goes on to say these "forces are already at work as is demonstrated by fee competition in many locales . . . in this highly competitive industry." *Id.*

have little to do with what lenders charge consumers, and finance charge amounts appear to be highly inelastic.

In particular, the study shows that in 89.27% of all loans, the loan's finance charge was for the maximum amount, to the very penny, allowed by the DDLA. Further, the trend over time shows a gravitation[91] by lenders to charge the maximum allowable finance charge, with 91.70% of all loans written in 2003 for the maximum charge. In 2004, that figure rose to 92.75%.

Where there is any "competition" in finance charge pricing, it occurs primarily in what can be characterized as "promotional" loans. For example, some lenders offer discounts to consumers for the consumer's very first loan; others will discount, for example, every tenth loan. Additionally, some lenders may offer discounts to consumers who refer new business. Other than these types of "promotional" activities, very few lenders regularly charge the consumer anything less than the maximum the DDLA allows.[92]

Accordingly, it does not appear that competitive "market-place forces" are what drive payday loan fees.[93]

E. The Consecutive Loan and Repeat Customer – the Lenders' Bread and Butter

A common concern among consumer advocates and others involves the so-called "debt treadmill" or "debt cycle" in which payday loan borrowers often find themselves.[94] That is, many consumers who take out a

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91. Or, perhaps more accurately, a "levitation."

92. The study revealed that some lenders will round down to the nearest dollar the finance charge on certain "odd-amount" loans (e.g., charging $71 instead of the maximum allowable $71.25 on a $450 loan). A few lenders charge a straight 15% finance charge regardless of the size of the loan. However, as shown by the data, these instances are rare.

93. This result should not be surprising. Consumers who find it necessary to patronize payday lenders likely are in dire financial straits. *See* Jackson v. Check 'N Go, Inc., 193 F.R.D. 544, 547 (N.D. Ill. 2000) (observing that consumers would not borrow money from payday lenders, at triple digit interest rates, unless "necessitous"); *see also* Taylor v. Halsted Fin. Serv., LLC, No. 99 C 2466, 2000 WL 33201925, *8-10 (N.D. Ill. Jan. 13, 2000) (granting class certification in action against payday lender where putative class members alleged to be "poor and unsophisticated or financially necessitous"). Further, it long has been a paradigm of usury jurisprudence that necessitous borrowers are willing "to concede whatever may be demanded or to promise whatever may be exacted in order to obtain temporary relief from financial embarrassment." Hurt v. Crystal Ice & Cold Storage Co., 286 S.W. 1055, 1056 (Ky. 1926); *see also*, Wilcox v. Moore, 93 N.W.2d 288, 291 (Mich. 1958) (noting purpose of usury laws "is to protect the necessitous borrower from extortion"). Thus, it may be inferred that consumers who, by reason of their financial circumstances, need payday loans largely are rate insensitive. *See also* Bruch, *supra* note 11, at 1282-83 (noting because payday loan consumers are often in dire financial straits with nowhere else to go, they are unable to exercise meaningful choice and payday lenders enjoy a "captive market"); Drysdale, *supra* note 11, at 662 and nn.442-44 (showing that justification for payday loans – that consumers face financial emergencies with nowhere else to go – belies contention that market forces are at work); Schaaf, *supra* note 11, at 344, 345 (noting that by reason of their financial situation, payday loan consumers are not "price driven").

94. *See*, *e.g.*, Drysdale, *supra* note 11, at 605-09 (reporting on "debt treadmill"); Barr, *supra* note 17, at 157-58 (observing "debt trap" resulting from payday loans); Bruch, *supra* note 11, at

payday loan are unable to pay off the loan in full on its due date. The lenders will then allow the consumer to renew the loan for an additional period of time by paying an additional finance charge. This cycle is repeated over and over, with the borrower continually renewing the loan but never getting out from under the loan by paying it off completely. In one seminal case, a consumer initially borrowed $300 and, after renewing the loan numerous consecutive times over an eight month period, in which she paid the lender a total of $840 in finance charges, ended up defaulting on the loan.[95]

In what is perhaps the most striking aspect of the study is the confirmation that Colorado payday loan consumers also often find themselves trapped in a cycle of debt. This is true despite the DDLA's one-renewal limit.[96] Indeed, it is the "repeat" customer that accounts for the overwhelming majority of the payday lender's loan volume and revenue, i.e., its "bread and butter."

I start with the overall picture. According to the study, the average payday loan consumer obtains 9.38 payday loans from the same lender within any given twelve-month period. Therefore, using the study's average loan amounts, finance charges, and loan terms,[97] the average payday loan consumer pays a total of $477.16 in finance charges and is indebted for a total period of just over five out of twelve months *at each licensed payday lender location with which the consumer does business*.[98]

These figures present only the gross picture. A more in-depth analysis of the data reveals a sharper, and perhaps starker, image. It is to that picture I now turn.

First, the study's empirical data likely understates the frequency with which the "average" consumer obtains a payday loan or the overall length of time, in any given time period, in which that consumer is indebted to a payday lender. Specifically, and similar to other regulators' studies,[99] the study's data collection and analysis so far does not entail a cross-referencing of consumers between or among several payday lenders. Accordingly, the study does not account for whether an individual consumer obtained or had outstanding loans from more than one licensed

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1273-74 (payday loans create "debt treadmill"); FOX & MIERZWINSKI, *supra* note 17, at 7 (payday loan consumers run high risk of "becoming trapped in perpetual debt"); *see also* Schaaf, *supra* note 11, at 345-47 (high cost of payday loans causes consumer to become captive to lender).

95. *See* Turner v. E.Z. Check Cashing of Cookeville, Tennessee, Inc., 35 F. Supp. 2d 1042, 1046 (M.D. Tenn. 1999).

96. COLO. REV. STAT. § 5-3.1-108(1) (2005); *see supra* text accompanying note 13.

97. *See supra*, Part VI.C.

98. $50.87 average finance charge times 9.38 loans equals $477.16. The 16.63 day average loan term times 9.38 loans equals 155.99 days, or a little over 5 months.

99. *See*, *e.g.*, FOX & MIERZWINSKI, *supra* note 17, at 8 (observing that several regulators' studies do not include information on rate at which consumers borrow from more than one lender); ERNST, *supra* note 17, at 5 n.14, 7 (same).

location.[100] Nevertheless, anecdotally there is evidence that indicates consumers may have more than one payday loan outstanding to more than one payday lender at any one time, and that consumers borrow regularly from more than one payday lender.[101] Further, this evidence indicates that consumers often will "borrow from Peter to pay Paul," that is, they will obtain a payday loan from one lender in order to pay off an outstanding payday loan due another lender.[102] Based on this anecdotal evidence, it is likely that the gross "averages" set out above underreport the true nature of the "debt trap" in which consumers find themselves.[103]

Second, the study shows that the "repeat" consumer – i.e., a borrower who obtains more than the occasional loan from the same lender in a given period - accounts for the bulk of payday lenders' loan volume and revenue. For example, according to the study consumers who obtained sixteen or more payday loans with the same lender in any twelve-month period accounted for 20.10% of all payday loan borrowers. These consumers accounted for nearly half – 46.72% - of lenders' total annual loan volume. Indeed, nearly two-thirds (65.42%) of a lender's annual loan volume is comprised of consumers who borrow twelve or more times a year, yet these consumers make up only 33.34% of all payday loan borrowers. *See* Figures 4-6.

As these figures demonstrate, the "repeat" consumer accounts for a disproportionately large share of lenders' revenues. From this, it may be concluded that Colorado payday lenders derive the majority of their revenues from, and hence are economically dependent upon, the "repeat" borrower.[104]

100. The DDLA does not prohibit one payday lender from extending a loan to a consumer who may be indebted to another separate payday lender.

101. During their regular compliance examinations, the examiners saw many of the same consumers' names appearing time and again in various lenders' records. *See also* ERNST, *supra* note 17, at 7 (reporting survey showing 47% of payday loan borrowers use more than one lender per year).

102. *See*, *e.g.*, Drysdale, *supra* note 11, at 601; Johnson, *supra* note 2, at 57; Barr, *supra* note 17, at 156.

103. Recently, the Administrator undertook a limited exercise of the type of precise examination that so far is absent from the study. She compared all individual consumers who had loans outstanding at a group of different Front Range, Denver/Colorado Springs metro area payday loan locations during one week in March 2005. Although the data from this comparison is limited, is not part of the main study, and no broad conclusions should be drawn therefrom, this data reveals the following. This group of locations had loans with a combined total outstanding (net of finance charges) of just over $3 million ($3,019,228) from 7,358 consumers. A little over 20% of these consumers (20.11%) had multiple loans outstanding at any one time from more than one of these locations. These multiple-loan consumers accounted for a disproportionate 38.75% of outstanding loan volume. Further, the average loan amount generally increased with the number of outstanding loans, starting at $324.14 for consumers with two outstanding loans and rising to $347.14 for consumers with six outstanding loans. Two consumers had seven loans outstanding at one time. Their average loan amount was $485.71, meaning that some consumers may have as much as or more than $3,400 in payday loans outstanding at any one time. This limited comparison suggests confirmation of the anecdotal evidence reported above.

104. This result is consistent with what has been reported elsewhere. *See*, *e.g.*, Drysdale, *supra* note 11, at 608 (both Indiana and Illinois report that repeat customer is lenders' main source of

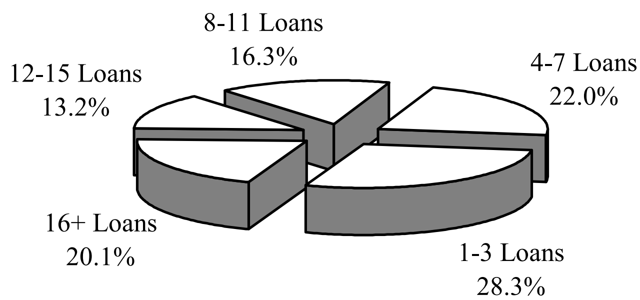


Figure 4: Proportion of DDLA consumers by number of loans (preceding twelve months).

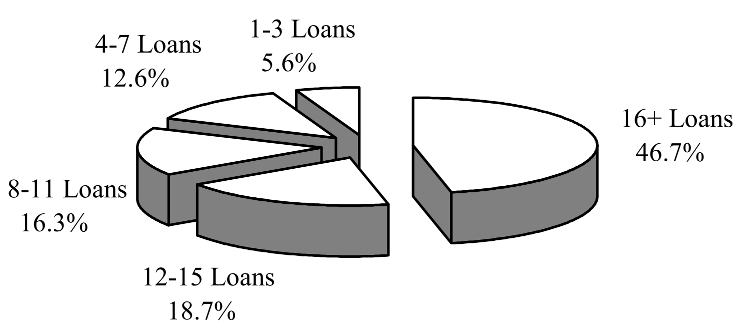
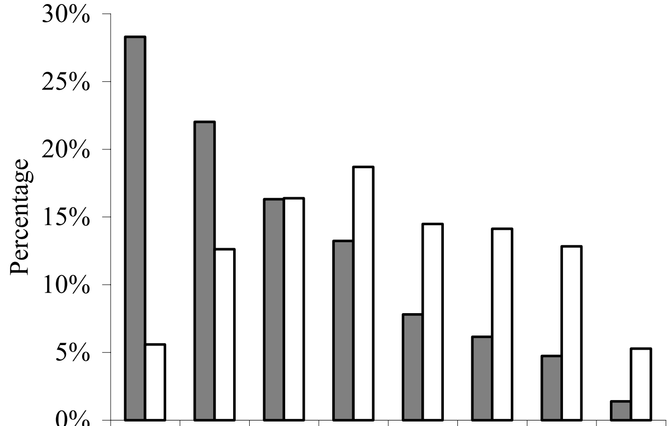


Figure 5: Proportion of lenders' DDLA loan volume by consumer loan frequency (preceding twelve months).

revenue); Barr, *supra* note 17, at 157 (frequent-use customers are "revenue drivers" for payday industry (citing North Carolina statistics)); ERNST, *supra* n.17, at 4-5 (based on analysis showing that 56% of payday industry revenues are generated from consumers with 13 or more loans per year and other studies, authors conclude industry relies on "business model that encourages chronic borrowing" and that such "churning" "is largely responsible" for industry's volume).



	1-3	4-7	8-11	12-15	16-19	20-23	24-27	28 +
■ % of Consumers	28.3	22.0	16.3	13.2	7.8%	6.2%	4.8%	1.4%
□ % of Volume	5.6%	12.6	16.4	18.7	14.5	14.1	12.8	5.3%

Number of Loans Per Individual

Figure 6: Comparison of proportions of DDLA consumers and proportion of loan volume (preceding twelve months).

Third, the study indicates the issue of renewals is of significant concern. As previously mentioned, a renewal occurs when, at the end of the initial loan's term, the consumer pays just the loan's finance charge to extend the loan for an additional term.[105] As above mentioned, the DDLA limits to one the number of times a lender may consecutively renew a payday loan.[106]

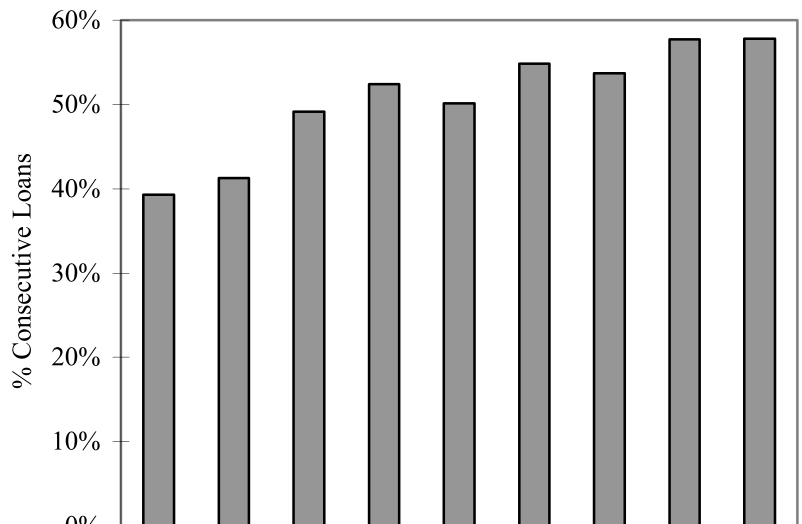
According to the study, 18.85% of all payday loan transactions are renewals. Further, this appears to be an increasing trend. For the calendar year 2003, this percentage grew to 19.56%, and in 2004 the rate was 20.28%.

Fourth, and perhaps more pernicious because they are unregulated, are the non-renewal rollovers.[107] According to the study, a third of *all* payday loan transactions - 34.40% - involve same-day, or "touch and go," rollovers. As with true renewals, this trend is increasing – for 2003, 34.70% of all loan transactions were "touch and go" rollovers, and in 2004, this figure increased to 37.48%.

105. *See supra* text accompanying note 12.
106. *See* COLO. REV. STAT. 5-3.1-108(1) (2005); *see also* text accompanying note 13.
107. *See supra* Part I and note 12 (distinguishing between renewals and rollovers).

As mentioned, although the DDLA limits to one the number of renewals, there are *no* limits to the number of times a lender may "rollover" a loan by extending a new loan to the consumer immediately after the consumer pays off a previous loan.[108] However, the net economic effect of these types of "rollovers" is identical to that of a "true" renewal: (1) the consumer does not receive any net funds; (2) for the net payment of an additional finance charge, the lender extends the consumer's loan for an additional term; and (3) at the end of the additional term, the consumer still owes the same principal amount of the first loan.[109]

When the numbers of both true renewals and rollovers (collectively called "consecutive" loans) are summed together, it is seen that consecutive loans make up the majority of *all* payday loan transactions. Over the course of the study, consecutive loans comprised 53.25% of all loans made. Further, this percentage has climbed steadily over time – in 2003, 54.25% of all loans were consecutive, rising to 57.76% in 2004. *See* Figure 7.



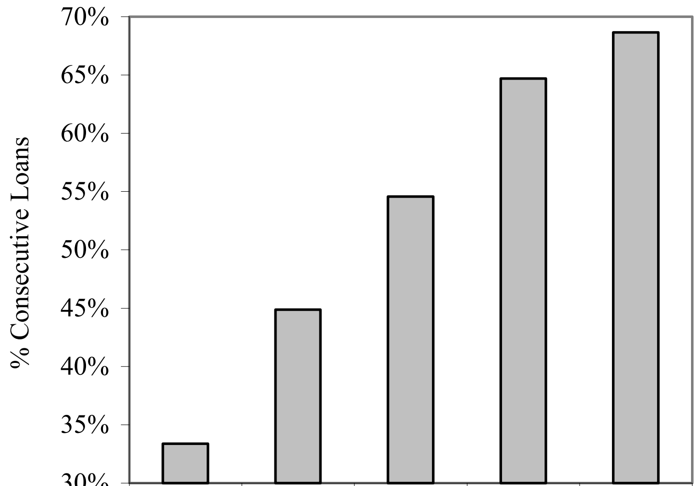
	2nd Half 2000	1st Half 2001	2nd Half 2001	1st Half 2002	2nd Half 2002	1st Half 2003	2nd Half 2003	1st Half 2004	2nd Half 2004
%	39.3%	41.3%	49.1%	52.4%	50.2%	54.8%	53.7%	57.7%	57.8%

Figure 7: Proportion of "consecutive loans."

108. *See supra* text accompanying note 16.

109. *See, e.g.*, Barr, *supra* note 17, at 156; ERNST, *supra* note 17, at 3-4; Drysdale, *supra* note 11, at 601 (all observing that a "touch and go" or like "rollover" transaction is the functional and economic equivalent of a "true" renewal; both cases result in a continuous flow of interest-only payments, with no reduction in principal).

Further, the study shows a direct correlation between the loan amount and the percentage of loans that were consecutive. Not surprisingly, the larger the loan, the more likely it is that the consumer will repeatedly roll it over. *See* Figure 8.



	$0-$100	$101-$200	$201-$300	$301-$400	$401-$500
% Consecutive Loans	33.4%	44.9%	54.6%	64.7%	68.7%

Figure 8: Proportion of "consecutive" loans by amount.

Importantly, because a "touch and go"-type rollover ostensibly is a "new" loan, and not a "renewal" subject to the DDLA's one-renewal limit, a lender can alternate true "renewals" with "rollovers" indefinitely, *ad infinitum*. In this way, a lender easily can circumvent the DDLA's limits on renewals.[110] This lack of regulation over rollovers, together with the revenues derived from and dependence upon the "repeat" customer, may create an incentive for some less scrupulous payday lenders to disguise their renewals. That is, they may structure the transaction so that it in form appears to be a lawful payoff in full of one loan followed immediately by a new loan, but that in reality is a renewal with no exchange of moneys between the borrower and the lender other than the borrower's payment of an additional finance charge.[111]

110. *See, e.g.*, FOX & MIERZWINSKI, *supra* note 17, at 8-9 (state law renewal limits easily evaded via "touch and go's"); Barr, *supra* note 17, at 158 (lack of regulation on same-day advances "leave[s] open a big loophole" to evade renewal limits).

111. Colorado is no stranger to such disguised renewals. In *In Re* Kentucky Cash Connection, LLC, No. CCC 2002-001 (Adm'r Colo. Uniform Consumer Credit Code July 18, 2003) (final agency order) (on file with Office of the Colo. Att'y Gen.), the Administrator required a payday lender to surrender its licenses where the Administrator alleged the lender renewed its loans more than once in violation of the DDLA's one-renewal limit. In that case, two former high-ranking executives of the lender provided testimony that the lender falsified its records to make it appear as

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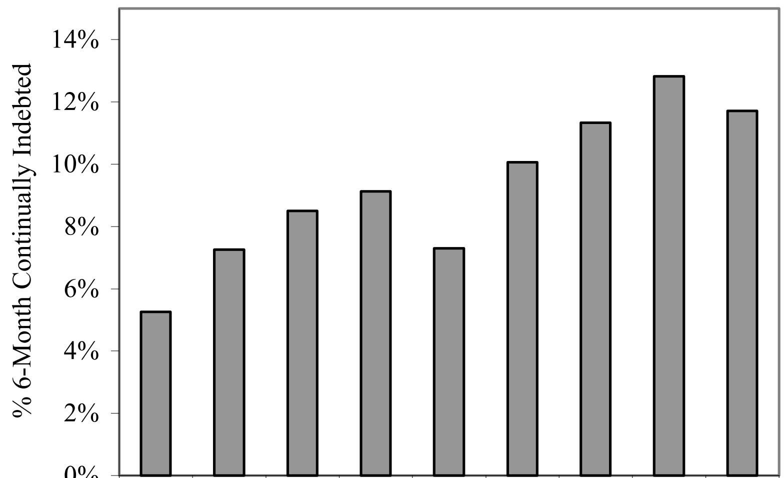
Indeed, the study reveals that lenders' continually extending numerous, consecutive loans to consumers – whether by lawfully alternating "true" renewals with "touch and go" rollovers or otherwise – occurs with perhaps inordinate frequency. According to the study, 10.16% of all consumers were continually indebted to the same location being examined *every single day* of the six months preceding the particular examination. This figure has been rising steadily over time. *See* Figure 9.



	2nd Half 2000	1st Half 2001	2nd Half 2001	1st Half 2002	2nd Half 2002	1st Half 2003	2nd Half 2003	1st Half 2004	2nd Half 2004
%	5.3%	7.3%	8.5%	9.1%	7.3%	10.1%	11.3%	12.8%	11.7%

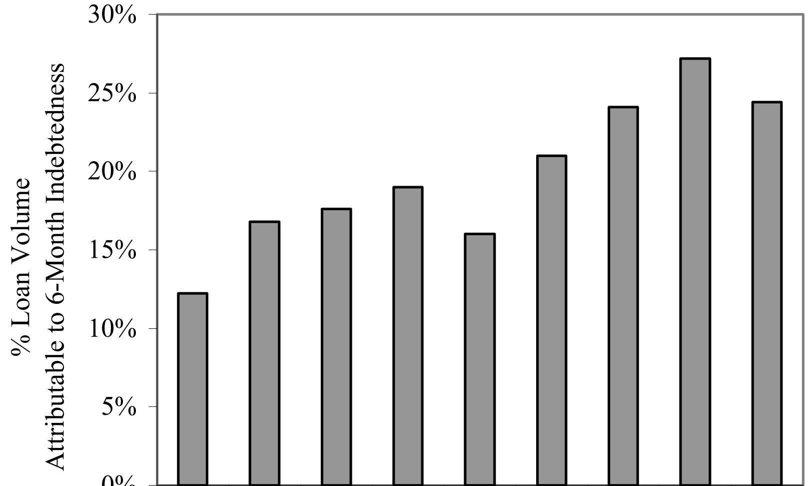
Figure 9: Proportion of six-month continually indebted customers (at one location).

Further, as with "repeat" borrowers, these continually-indebted consumers account for a disproportionately large share of the lenders' annual total loan volume. For example, study-to-date, the six-month continually indebted consumers represent 20.4% of lenders' total annual loan volume. This figure, too, has risen over time. *See* Figure 10.

The foregoing data confirm, and are consistent with, results reported and theories advanced elsewhere. First, despite the DDLA's one-renewal limit, Colorado payday loan consumers are not protected against the continual cycle of debt, or "debt treadmill," common to the payday

if the unlawful multiple renewals were new, rollover same-day "touch and go" loans. *See also* Graves & Petersen, *supra* note 18, at 92 (citing to and reporting on *In Re* Kentucky Cash Connection).

loan industry.[112] Second, and perhaps of greater concern, is the industry's financial dependence upon the "repeat," "debt trapped" consumer; indeed, this appears to be the industry's very business model.[113]



	2nd Half 2000	1st Half 2001	2nd Half 2001	1st Half 2002	2nd Half 2002	1st Half 2003	2nd Half 2003	1st Half 2004	2nd Half 2004
%	12.2	16.8	17.6	19.0	16.0	21.0	24.1	27.2	24.4

Figure 10: Proportion of total loan volume attributable to six-month continually indebted consumers.

VII. RECOMMENDATIONS

The study's data and analysis expose significant problems in current Colorado payday loan regulation. These problems are directly traceable to flaws and shortcomings in the DDLA. However, these flaws easily are rectified by conceptually simple changes to the statute. In no particular order of priority, I offer some modest proposals.

First, to help combat the problems of "loan splitting" and "steering" of consumers to particular loan amounts, the DDLA's current "step-rate" finance charge provision should be eliminated. There should be one, and only one, maximum allowable finance charge rate, regardless of the size

112. *See supra* text accompanying note 94.

113. *See, e.g.*, Bruch, *supra* note 11, at 1281 (through continual rollovers, lenders encourage consumers "to prolong their ride on the "debt treadmill"); Johnson, *supra* note 2, at 69-71 (because repeat transactions generate majority of lender revenue, "rollover practice is part of its business model"); ERNST, *supra* note 17, at 4-5 (payday loan industry "relies on business model that encourages chronic borrowing.").

of the loan. This change also would help lenders by simplifying the loan process and their concomitant finance charge and APR calculations.

Second, to further prevent "loan splitting" and potential circumvention of both the maximum loan amount and renewal limits, the DDLA's definition of "lender" should be amended to include affiliates or similar related entities. To illustrate, under the DDLA's current form, one "head" payday lender might set up a number of ostensibly separate, independent "lender" companies, but which in reality are closely related and inter-connected "tentacles," such as through common ownership or management. By using this structure, together with a business model of shuffling consumers between and among the various "tentacles," the "head" lender may attempt to circumvent renewal or loan amount limitations. Notably, both Rule 7 and the Committee's draft legislation defined "lender" to include affiliates[114] and would have prevented this device; this omission from the DDLA should be corrected.

Third, to alleviate the perceived difficulty in enforcing the Code's current "loan splitting" prohibition,[115] the section should be restored to its pre-1975 version.[116] In this way, unlawful "loan splitting" would not be dependent upon a determination of the lender's "purpose" of, but instead would occur where the "result" was in, obtaining a higher finance charge.

Fourth, the study reveals a gaping disconnect between the theory and expressed purpose of payday loans, on the one hand, and their reality, on the other. That is, although these loans are intended for one-time, emergency purposes[117] - a theory the industry purports to embrace[118] - their reality presents a starkly different picture, one inhabited by consumers repeatedly rolling over their "emergency," "stop-gap" loans. The DDLA's one-renewal limit has proven ineffective in eliminating the debt trap common to payday lending. Indeed, the disproportionate contribution the repeat consumer makes to lenders' revenues likely entices lenders to allow, and perhaps encourage, borrowers to obtain numerous, continual consecutive loans. The study shows lenders find this temptation hard to resist. Because the DDLA does not regulate non-renewal rollovers, it does not discourage lenders from succumbing to this temptation.

Further, because the DDLA does not prevent one payday lender from extending a payday loan to a consumer to payoff a payday loan due

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114. *See supra* Parts III-IV.

115. *See* COLO. REV. STAT. § 5-3-205 (2005); *supra* Part III.

116. *See* 1975 Colo. Sess. Laws 247 (amending § 5-3-409).

117. *See* COLO. REV. STAT. § 5-3.1-104 (2005) (requiring lenders to provide notice to consumers that payday loans are not "intended to meet long-term financial needs" but "should be used only to meet short-term cash needs").

118. *See* Freedom of Choice for Consumers, *supra* note 83 (payday loans are intended for emergency, "stop-gap" needs). This report goes on to claim that "[d]eferred deposit service businesses *do not want to do business with customers engaged in excessive rollovers.*" *Id.*

another lender – i.e., the "borrowing from Peter to pay Paul" syndrome – it does nothing to cut off the unending debt cycle. Instead, it allows the cycle to be transferred from one lender to another.

Therefore, the DDLA should be amended to prohibit the practice of using one payday loan to pay off another. Additionally, it should mandate a "cooling off" period of, say, seven days, between the time one payday loan is paid off and the time any lender may extend a new payday loan. To facilitate and make effective these provisions, the DDLA should provide for the creation of a statewide database, to which all payday lenders must subscribe, containing information on consumers and their payday loans.[119] Before a lender may extend a payday loan to a consumer, the lender must verify from the database the consumer's eligibility for a loan.

Fifth, the DDLA currently prohibits any one lender from having more than $500 in payday loans outstanding to any one consumer at any one time.[120] However, this prohibition does not prevent another lender from extending another payday loan to the consumer at the same time. Thus, a consumer could have a number of payday loans outstanding at any one time from a number of different lenders, with each loan up to the maximum $500 limit.[121] This exacerbates the debt treadmill problem.

Accordingly, the DDLA's current prohibition should be expanded so as to prohibit a lender from extending a payday loan to a consumer who has a payday loan outstanding from any other payday lender. Here, too, there should be created a statewide database that the lender would be required to consult in order to verify the consumer's loan eligibility. An alternative, but more limited, expansion of the prohibition is to prohibit a lender from extending a payday loan in an amount that would cause the consumer's aggregate outstanding payday loans, from *all* lenders, to exceed $500. However, this alternative may defeat the purpose and effectiveness of the cooling off period. For example, this alternative allows several small loans, whose aggregate amount falls under the cap, to be extended to one consumer, but whose terms and due dates are staggered. By staggering the terms, so that the loans overlap, the consumer is never truly out from under the debt trap of a payday loan.

The sixth recommendation does not derive from the study, but instead from amendments to the DDLA, contained in House Bill (HB) 04-

119. The concepts of statewide databases and "cooling off" periods are not novel. *See*, *e.g.*, FLA. STAT. § 560.404(19) (2005) (24-hour cooling off period); FLA. STAT. § 560.404(23) (2005) (database); 815 ILL. COMP. STAT. 122/2-5(b) (2005) (seven day cooling off period); 815 ILL. COMP. STAT. 122/2-15 (2005) (database); IND. CODE.§ 24-4.5-7-401(2) (2005) (seven day cooling off period); IND. CODE § 24-4.5-7-404(4)(b) (2005) (database); N.D. CENT. CODE § 13-08-12(4) (2005) (three business day cooling off period and database).

120. *See* COLO. REV. STAT. § 5-3.1-106(1) (2005).

121. *See supra* note 103.

1069, enacted during the 2004 legislative session.[122] I start with some background.

Contained in the Code is the concept and doctrine of "unconscionability."[123] This doctrine prohibits creditors from making "unconscionable" consumer credit transactions and provides various remedies, in favor of both consumers and the Administrator, in the event a court determines a transaction is "unconscionable."[124] One factor a court is to consider in making this determination is whether, at the time the transaction was made, the creditor had a reasonable belief that the consumer had the ability to repay the transaction according to its terms.[125]

In 2002, the Administrator issued an advisory opinion letter concerning "unconscionability" and its incorporated "ability to repay" requirement.[126] Specifically, she reminded payday lenders that this doctrine applied to them and their loans to the same extent as it applied to any other lender or any other consumer credit transaction.[127] She stated that, under the doctrine, the Code "obligates a responsible lender to inquire about a consumer's repayment ability whenever a loan is made," which "logically . . . includes reviewing" the consumer's assets and income versus his or her liabilities.[128] She observed that it was the practice of some payday lenders *not* to perform such typical loan underwriting diligence and *not* to inquire into such things as the consumer's income or credit worthiness.[129] She advised that payday lenders, who did not verify a consumer's "ability to repay," ran substantial risks that their loans might be declared unconscionable and "strongly discouraged" such practices.[130]

Payday lenders, through their industry trade associations,[131] objected to what they perceived as the Administrator's imposition of unreasonable burdens on their lending practices.[132] In response to these objections, and the lenders' requests for specific guidance as to what may or may not be "unconscionable" practices, in 2003 the Administrator issued a revised opinion letter.[133] Although she acknowledged that (1) the un-

122. *See* 2004 Colo. Sess. Laws 317-21 (enacting HB 04-1069).

123. *See* COLO. REV. STAT. §§ 5-5-109, 5-6-112 (2005).

124. *See id.*

125. *See* COLO. REV. STAT. § 5-6-112(3)(a) (2005).

126. *See* Admin. Opinion Letter, "Reasonable Probability of Payment in Full and Record Retention" (Adm'r Colo. Consumer Credit Code Dec. 2, 2002), at 1 (on file with Office of the Colo. Att'y Gen.).

127. *Id.* at 1.

128. *Id.* at 2.

129. *Id.* at 1, 2.

130. *Id.* at 2.

131. Specifically, the CFSA and the Colorado Check Holders Association. *See* Admin. Opinion Letter, "Reasonable Probability of Payment in Full and Record Retention – Revised" (Adm'r Colo. Consumer Credit Code June 16, 2003), at 1, http://www.ago.state.co.us (on file with Office of the Colo. Att'y Gen.).

132. *See id.* at 1.

133. *See id.*

conscionability doctrine required flexibility in its application and depended upon a factual review of the transaction, and (2) she was statutorily prohibited from promulgating rules or regulations on unconscionability, she acceded to the payday lenders' requests by adopting enforcement policy guidelines and enumerating certain recommended practices that, if followed, would not result in the taking of any administrative enforcement action based upon a consumer's repayment ability (absent a complaint or specific evidence of inability to repay).[134] These guidelines covered such things as (1) the frequency with which a payday lender should obtain a new loan application and verify consumer income and employment, (2) minimum loan-to-income ratios, and (3) minimum loan terms and the scheduling of a payday loan's due date so as to coincide with or come after the consumer's next payday.[135]

Apparently, payday lenders remained unsatisfied. Accordingly, during the 2004 legislative session they pushed for and were the moving force behind HB 04-1069.[136] With the bill's passage, the industry might lay claim to have obtained three significant benefits.

First, the industry may claim the bill all but removes entirely the "ability to repay" concept from the Code's unconscionability doctrine for payday loans, save for minimal loan-to-income ratios and income verification requirements.[137] Thus, payday lenders might say they received legislative imprimatur allowing them to ignore basic loan underwriting diligence required of any other creditor to avoid having a transaction declared unconscionable.

Second, were this not enough, through the bill payday lenders sought to weaken further the "unconscionability" doctrine vis-à-vis payday loans by adding factors a court is to consider in making this determination.[138] These factors include weighing (1) the benefits of the loan to the consumer versus the lender's risk; (2) the absence of collateral other than the consumer's instrument; and (3) the relation between the amount of the payday loan and the cost in making it.[139]

On their face, these factors perhaps are not neutral but instead might be seen to be skewed heavily in favor of the payday lender. For example, the industry claims that (1) payday loans serve an essential consumer

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134. *See id.* at 2-5.

135. *See id.* at 3-4. The Administrator also made special mention of the "cycle of debt." She observed that some payday lenders' practices of allowing consumers to continually roll over their loans via a same day, "touch and go" new loan raised questions concerning the consumer's ability to repay the loan according to its scheduled terms. *See id.* at 4. One possible solution she advanced to address this concern was the concept of a central database. *See id.*

136. Of the industry's trade associations, it is significant that only the Colorado Check Holders Association spoke on the bill's behalf; in particular, neither the CFSA nor FiSCA publicly supported it. *See supra* note 83 (describing CFSA and FiSCA).

137. *See* 2004 Colo. Sess. Laws 320 (enacting COLO. REV. STAT. §§ 5-3.1-122(2) and (3)).

138. *See id.* (enacting COLO. REV. STAT. § 5-3.1-122(1)).

139. *See* COLO. REV. STAT. § 5-3.1-122(1)(a)-(c) (2005).

need not met by conventional sources of credit; (2) the fixed transaction costs associated with payday lending are significant in relation to the size of the loan and disproportionately higher than in conventional lending; (3) payday lenders' risks are higher than conventional lenders' risks; and (4) the benefits to the consumer of obtaining a loan far outweigh the alternatives and include such things as enhancing financial standing, avoiding the incurring of returned check charges, and not having to pledge tangible collateral as would be required in a comparable pawn transaction.[140] Further, these factors simultaneously (1) deprive payday loan consumers of protections to which all other borrowers are entitled under; and (2) give payday lenders anti-competitive advantages over all other creditors subject to; the Code.

Importantly, because it seemingly substantially eviscerates the "unconscionabilty" doctrine as applied to payday loans, HB 04-1069 may further aggravate the "debt cycle" problem.[141] That is, lenders who continually and repeatedly roll over their loans, and extend to consumers numerous consecutive loans, likely are unconcerned with whether a loan would be repaid according to its terms. Yet this practice would seem to be unconscionable on its face - such lenders cannot harbor a "reasonable belief" that the consumer would repay the loan as scheduled.[142] Further, because (1) as the study shows this practice accounts for the majority of lenders' revenues;[143] and (2) the DDLA currently does not prohibit the practice of repeatedly alternating renewals with rollovers, ad infinitum, HB 04-1069 potentially weakens a significant, and perhaps the only, deterrent against this practice and thereby encourages lenders to engage in it with apparent impunity.

Third, the bill provides payday lenders with special substantive and procedural protections, along with immunity from certain types of administrative discipline, in the event of administrative disciplinary proceedings arising out of violations of the Code.[144] These include such things as providing payday lenders with a limited "bona fide error" defense, allowing them a limited "right to cure," and giving them a ninety-day time period within which to comply with administrative rules, interpretations, or opinions.[145] Here, too, these special privileges apply only to payday lenders; no other supervised lender is accorded such status.

140. *See* Freedom of Choice for Consumers, *supra* note 83.

141. Whether this was an intended or unintended consequence of the bill is not known.

142. *See* Bruch, *supra* note 11, at 1280-82; *see also*, *e.g.*, *id.* at 1278-80 (describing how payday loans are otherwise unconscionable); RENUART & KEEST, *supra* note 11, § 7.5.5.6, at 301-02 (same).

143. *See supra* Part VI.E.

144. *See* 2004 Colo. Sess. Laws 319-20 (amending COLO. REV. STAT. § 5-3.1-118 by adding subsections (2)(c) and (3)).

145. *Id.*

HB 04-1069 is an example of special interest legislation. However, the legislation seems ill-advised. It must be remembered that payday lenders are allowed to make the most expensive, highest cost loans in Colorado, exceeding by several orders of magnitude Colorado's 45% criminal usury rate.[146] Further, payday lenders' clientele, by reason of their desperate financial circumstances, likely are the most vulnerable of borrowers and most in need of the Code's consumer protections. Yet, HB 04-1069 perhaps (1) deprives payday loan consumers of fundamental consumer protections to which all other borrowers are entitled; and (2) accords special treatment and privileges to payday lenders by: (a) carving out exemptions from Code provisions of general applicability; and (b) creating special procedural and substantive protections unavailable to any other creditor. This makes HB 04-1069 simultaneously both anti-competitive and anti-consumer protective. To restore a proper balance between the legitimate needs of payday lenders and their consumers, those aspects of HB 04-1069 that provide special privileges and protections to payday lenders should be repealed in their entirety. This includes the bill's provisions relating to the doctrine of "unconscionability" to ensure that the doctrine retains its full vigor and applicability to payday loans as it does to any other extension of credit.

CONCLUSION

Whether payday lending should be legal in Colorado is a debate that is beyond the scope of this article. For now, the General Assembly has concluded that it should be, albeit subject to and under the DDLA's regulation. Nevertheless, it must be remembered that payday lending is but the modern incarnation of what in earlier eras was outlawed and condemned as usurious loan sharking. Given its unsavory ancestry, the significant potential for abuse, and the devastating consequences of such abuse, payday lending demands the strictest of regulation and closest of scrutiny.

146. *See* COLO. REV. STAT. § 18-15-104(1) (2005).