How the Payday Predator Hides Among Us: The Predatory Nature of the Payday Loan Industry and Its Use of Consumer Arbitration to Further Discriminatory Lending Practices

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I. Introduction

“The pound of flesh which I demand of him Is dearely bought, 'tis mine, and I will haue it.”


The above quote comes from the character Shylock in Shakespeare’s The Merchant of Venice who demands a pound of Antonio’s flesh as security for a usurious loan. While the quote comes from a well known classic, there are modern day commercial actors who behave in very much the same manner as Shakespeare’s fictional Shylock – payday lenders. This article addresses the pound of flesh extracted by America’s modern day loan shark, the payday lending industry, on a daily basis from the economic well-being of society’s most vulnerable populations. Payday lending, a booming fringe banking industry, brings predatory lending activities to the doorsteps of some of our country’s poorest citizens. While the detrimental effects of this lending practice are well known, documented, and condemned, it seems that very few with the power to bring about change are willing to take the necessary steps to trigger that change, and those who try are stymied by systemic problems that prevent the effective regulation of payday lenders.

The ideas expressed in this article join a growing chorus of critiques of the payday loan industry from inside academia and consumer advocates. Specifically, this article shows the predatory nature of the payday loan industry and the specific, discriminatory targeting of minorities by that industry. The Article further argues that the payday loan industry uses consumer arbitration agreements to further its discriminatory lending practices.

Part II of this article clearly and formulaically articulates the predatory lending practices of payday lenders. It is important to develop a clear understanding of predatory lending and the predatory nature of the payday lending industry. Part II continues by demonstrating that the payday lending industry deliberately targets minorities, causing them to disproportionately bear the brunt of that industry’s predatory actions. Part III of this article reviews the use of arbitration agreements in consumer transactions in general, and specifically in the payday lending context, concluding that the use of such agreements should be restricted, particularly given the predatory nature of payday lending transactions. Part IV argues that corrective actions taken on a national scale...
level to protect military members from payday loan transactions should be applied universally and the fact that such protections have not been applied universally demonstrates the discriminatory nature of American politics. Ultimately, this article concludes that the failure to act uniformly to protect all of America’s citizens is in part due to the fact that scholars and activists have failed to unite efforts to correct large scale wrongs by focusing too much on identity politics and such forces should unite when there is a convergence of interests.

II. Payday Lending as a Predatory Lending Practice that Targets Disadvantaged Peoples

A. Predatory Lending

Predatory lending is notoriously difficult to define, with one observer noting that it is easier to discuss than it is to define. In fact, even the Federal Deposit Insurance Corporation (FDIC) has complained that “there is no simple checklist for determining whether a particular loan or loan program is predatory.” Predatory lending can include the lack of a fair exchange or loan pricing that is disproportionate to the risk that a borrower presents.

The lack of a clear definition of predatory lending makes regulating actors who engage in predatory practices quite difficult. Without a definition, opponents of any meaningful reform in this area claim that remedies are simply not needed. Most scholars in the area of payday lending seem to take the position, to borrow a phrase from Justice Stewart, “I know it when I see it.”

Because there is inherent confusion regarding the concept of predatory lending, a list of traits, or analytical guidelines, to characterize predatory lending is useful. Although this article focuses on payday lending, most of the scholarship addressing predatory lending revolves around home mortgage lending practices. Given the higher per-transaction value associated with purchasing a home compared to obtaining a payday loan, this home-mortgage focus makes sense. As such,

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See Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 511 (2002) (quoting Federal Reserve Board Governor Edward M. Gramlich: “The term ‘predatory lending,’ . . . is far reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or comprehensive definition” (internal citations omitted)).


4 See id.

5 See Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1259 (2002) (“In 2000, Senator Phil Gramm, then the chairman of the Senate Banking Committee, famously asserted that predatory lending could not be addressed until it could be defined.”).

6 See id. at 1260.

7 *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (concurring with the majority and attempting to describe pornographic material: “I shall not today attempt further to define the kinds of material I understand to be embraced within the shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that” (emphasis added)).
many of the predatory activities generally described by scholars do not, on their face, appear applicable to the payday lending transaction. However, the seemingly unrelated factors attributed to home-mortgage predatory lending practices are actually largely analogous to the tactics that payday lenders utilize. Thus, in this section the article identifies these analytical predatory lending guidelines, and then applies the guidelines to the specific practices of the payday lending industry in section I.A., infra.

Before establishing what types of behaviors constitute predatory lending, it is important to distinguish between subprime lenders and predatory lenders. Subprime lenders market financial products to borrowers who are considered higher credit risks than prime borrowers. The risks associated with subprime borrowers can be the result of the borrower’s poor credit ratings, low income, high debt-to-income ratio, prior bankruptcy, or anything that tends to indicate that the borrower will not perform as well as a prime borrower. While it is true that there are higher incidents of predatory lending in subprime markets, it does not necessarily follow that all subprime lenders are predatory actors. In fact, many subprime lenders are legitimate lending institutions that provide valuable services, like supplying needed credit to a large segment of the population. Conversely, though a prime lender may advance credit to more creditworthy customers at a prime rate, it does not necessarily mean that the prime lender cannot or does not engage in predatory lending practices. Accordingly, predatory lending is not limited to one class of borrowers.

Predatory lenders typically target customers that have insufficient experience, knowledge, and skills to understand the ramifications of the lending transaction that they are consummating. These customers often lack the ability to substantively assess their options. Predatory lending often includes targeted and deceptive advertising that focuses on a particularly vulnerable group or groups. Ultimately, predatory lenders engage “in deception or fraud, manipulating the

\textsuperscript{8} See Predatory Lending FDIC’s Supervisory Policy on Predatory Lending, supra note 3 (broadly describing the differences between the market niche that subprime lenders occupy and the act of predatory lending).

\textsuperscript{9} See id.

\textsuperscript{10} See Engle & McCoy, supra note 5, at 1265-66 (distinguishing the appropriately higher costs associated with the higher risk of subprime mortgage lending: “Subprime loans historically have had higher rates of delinquency, default, and foreclosure than loans in the prime market. As a result, they carry higher interest rates to compensate for the added risk. In addition, higher interest rates, either alone or with prepayment penalties, compensate lenders for the fact that subprime loans tend to be prepaid at a much faster rate that prime mortgages” (internal citations omitted)).

\textsuperscript{11} See Predatory Lending FDIC’s Supervisory Policy on Predatory Lending, supra note 3.

\textsuperscript{12} See id. at 1.

\textsuperscript{13} See Kathleen C. Engel, Do Cities Have Standing? Redressing the Externalities of Predatory Lending, 38 CONN. L. REV. 355, 356 (2006) (“Predatory lenders market their products to people who have little or no experience with mortgage loans and who do not have sufficient skills to untangle the maze of contract terms and engage in meaningful assessments of their options.” (internal citations omitted)).

\textsuperscript{14} See id.

\textsuperscript{15} See Melissa LaVenia, Developments in Banking and Financial Law:2006-2007: The Subprime Mortgage Crisis: XII. Predatory Lending’s Role in the Subprime Mortgage Crisis, 27 REV. BANKING & FIN. L. 2, 103 (2008) (“Demographically, minorities are much more likely to receive subprime mortgages than their white
borrower through aggressive sales tactics, or taking unfair advantage of a borrower’s lack of understanding about the loan terms. These practices are often combined with loan terms that, alone or in combination, are abusive or make the borrower more vulnerable to abusive practices.16

In a significant article that undertook to define predatory lending and then apply that definition to the home-mortgage market,17 Professors Kathleen Engel and Patricia McCoy (then at the Cleveland-Marshall College of Law) catalogued activities that indicate when a particular lending transaction is predatory, providing a useful diagnostic tool for identifying predatory loans:18

[F]ive basic problems emerge. We can thus define predatory lending as a syndrome of abusive loan terms or practices that involve one or more of the following five problems:

1. loans structured to result in seriously disproportionate net harm to borrowers,
2. harmful rent-seeking,19
3. loans involving fraud or deceptive practices,
4. other forms of lack of transparency in loans that are not actionable as fraud, and
5. loans that require borrowers to waive meaningful legal redress.20

According to professors Engel and McCoy, predatory loans will generally combine at least two of these problems.21 Additionally, Professor Kurt Eggert of the Chapman University School of Law analyzed predatory lending in his article Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine.22 Professor Eggert points out that one root cause making it difficult to define predatory lending is that many predatory lending practices

counterparts. Though minority homeownership rates have historically been 25 percent below that of white homeowners, the Federal Reserve believes only a fraction of this difference can be explained by differences in income. Predatory practices may account for part of this discrepancy, as predatory lenders take advantage of unsophisticated borrowers who have not had much (if any) prior experience with homeownership or owning large assets.” (internal citations omitted)).
16 Eggert, supra note 2, at 512 (internal citations omitted).
17 Engle & McCoy, supra note 5.
18 Id. at 1260.
19 Professors Engel and McCoy define rent-seeking as follows: “[W]hen subprime lenders use their market power to charge rates and fees that exceed the rates and fees they would obtain in a competitive market, they extract harmful rents from borrowers. Such rent-seeking is another common feature of predatory lending.” Id. at 1265. Additionally, excessive rent-seeking includes padding the transaction with excessive, hidden, or deceptive fees. Id. at 1266.
20 Id. at 1260.
21 See id. at 1261 (“Most, if not all, predatory loans combine two or more of these problems. Similarly, some abusive terms or practices fall into more than one category.”).
22 Eggert, supra note 2.
are "on their face, . . . indistinguishable from legitimate lending activities." Professor Eggert posits that predatory lending essentially consists of two types of activities. The first type involves actions that are "either clearly illegal or unconscionable by their very nature." This class of predatory lending activities encompasses misrepresentation and the forging of signatures. The second class of activities typifies the difficulty of policing predatory practices: activities that are essentially legal, but when misused by unscrupulous lenders, take undue advantage of borrowers. From this second type of activity, Professor Eggert distilled a list of tools employed by predatory lenders in the home mortgage market. Of those tools, the following are relevant to the critique of the payday lending industry:

1. Fees and interest rates far greater than necessary to provide a reasonable return;
2. Flipping, which is the early or frequent refinancing of a loan (analogous to the payday loan industry practice of "rollover" discussed in section IA, infra);
3. High pressure and misleading sales and marketing techniques; and
4. Excessive prepayment penalties (analogously referred to as the "anti-payment" penalty in the payday loan industry discussed in section IA, infra).

Rather than functioning like a proposed statutory framework, this list, and the list proposed by Professors Engel and McCoy, are better utilized as a framework within which predatory lending practices in general, and the payday lending industry specifically, can be analyzed. When conducting an analysis, though, it is most important to recognize that both individuals and communities are harmed by predatory lending.

B. How Payday Lending Works and its Predatory Nature

23 Id. at 512.
24 Id.
25 See id.
26 See id. (“Practices such as balloon payments, adjustable rate mortgages, rapid refinancing of existing loans, and even high interest rates and fees could be used in non-predatory loans. For example, a borrower might choose to pay a higher interest rate in order to pay lower fees, or choose an adjustable rate loan to pay an initially lower interest rate. As long as these terms that benefit lenders to the detriment of borrowers are understood by borrowers and negotiated by them, borrowers can either receive something in return for the loans or decide to forgo the loan. These terms become the tools of predatory lenders when, as is common in the subprime market, they are neither negotiated over nor understood by the borrowers, and when borrowers receive little in return for agreeing to them.”) (emphasis added) (internal citation omitted)).
27 Id. at 514-19.
28 Engle & McCoy, supra note 5, at 1261. Professors Engel and McCoy suggest that "[r]ather than serving as a proposed statutory definition, our definition of predatory loans is intended as a diagnostic tool for identifying problematic loan practices that require redress." This approach is equally applicable to the tools of the predatory lender posited by Professor Eggert. See supra text accompanying notes 27-28.
29 See Predatory Lending FDIC’s Supervisory Policy on Predatory Lending, supra note 3, at 3.
At first, a typical payday lending transaction appears to be relatively straightforward and simple. However, upon further examination of the transaction itself, or, perhaps more correctly, the series of transactions that the initial advance leads to, the transaction is significantly more complicated and expensive than it initially appears. Additionally, the common marketing and collection practices utilized by payday lenders indicate that payday lending is predatory in nature. Part 1 of this section describes the payday lending transaction and the revolving debt cycle that it can become for a borrower. Part 2 of this section analyzes the practices of the payday lending industry, employing the analytical guidelines established in IIA, supra.

1. The Payday Loan Transaction and Practices of the Payday Lending Industry

Compared to a traditional consumer loan, the payday lending transaction is very simple to consummate. A typical consumer lending transaction includes credit check, an analysis of the potential borrower’s debt-to-income ratio (either through the credit scoring process or by the lending institution), verification of the potential borrower’s identity through a governmental ID card and social security number, and verification of the borrower’s address. Much of this process is transparent to the borrower at the ground-level transaction because it is often completed at the credit check stage.

A payday loan, on the other hand, requires much less. There is no credit check, nor an analysis of the borrower’s debt-to-income ratio. The process affords little concern for the borrower’s ability to repay. Instead, payday lenders typically require a driver’s license, paystub or other proof of income, bank statement, telephone bill, and checkbook.

31 See Mary Spector, Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences, 57 DEPAUL L. REV. 961, 966 (2008) (“Regardless of the borrower’s race or occupation, the payday borrower’s ability to repay the loan is only minimally considered.”); Uriah King, Wei Li, Delvin Davis, & Keith Ernst, Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina, CTR. FOR RESPONSIBLE LENDING, at 3 (Mar. 22, 2005) <www.responsiblelending.org> (“Payday loans are typically originated without traditional underwriting and thus disregard debt-to-income standards.”).
32 See Creola Johnson, Payday Loans: Shrewd Business or Predatory Lending?, 87 MINN. L. REV. 1, 9 (2002) (“To apply for a loan, a consumer usually needs to present a driver’s license, pay stub, bank statement, telephone bill, and checkbook.”); Spector, supra note 31, at 966 (“[O]nly a current pay stub or other proof of regular income is needed [to obtain a payday loan].”).
Payday loans generally involve small dollar amounts, usually between $50 and $1000. The borrower either writes a post-dated check or authorizes an electronic debit from her checking account for the amount of the loan plus a fee associated with the loan. The borrower generally promises to repay the loan by her next payday, usually within two weeks, or authorizes the payday lender to cash the check or debit her account. The fees for obtaining a payday loan vary depending upon the size of the loan, but generally range from $15 to over $50 dollars. While this additional cost is often described as a mere fee, from a credit perspective it is essentially a finance charge—what it will cost the customer to receive the cash advance. Characterized as a finance charge, and thusly expressed as an annual percentage rate (APR), the unduly high cost of credit to the payday loan customer is readily apparent: for a $200 loan with a fourteen-day term, at a $15 fee per $100 borrowed it will cost the customer $230. This translates to a 390% APR for a $200 loan. Depending on the jurisdiction and transaction, the APR for a payday loan can reach even higher, ranging from 400% to an astounding 910%.

The upfront transaction costs required to enter into a payday loan transaction, as astonishing as they may be, are just the beginning of the credit costs to most payday loan customers. These costs are compounded by pernicious acts employed by the payday lending industry, like refusing to allow customers to make partial payments on the principal borrowed. Although the typical payday loan transaction begins with a cash advance ostensibly limited in time by only one pay

33 See Spector, supra note 31, at 961 (“Also known as payday advance, a deferred presentment transaction, or a deferred deposit advance, the payday loan is a small-dollar, short-term, unsecured loan that borrowers promise to repay within a matter of weeks, often out of their next paycheck.”); Dawn Goulet, Note, Protecting Our Protectors: The Defense Department’s New Rules to Prevent Predatory Lending to Military Personnel, 20 LOY. CONSUMER L. REV. 81, 83 (2007) (“Payday loans . . . are transactions in which the borrower obtains a minimal cash advance, typically between $100 and $500, on his salary for two weeks.”); Johnson, supra note 32, at 9-10 (“Assuming a customer qualifies for a payday loan, a nontraditional lender makes a small cash advance (ranging from $50 to $1000) to the consumer in exchange for the consumer’s post-dated personal check written for the amount of the loan plus a fee.”).

34 See Goulet, supra note 33, at 83; Johnson, supra note 32, at 9-10.

35 See Goulet, supra note 33, at 83 (noting that the fees customers pay is typically between $15 and $35); See Predatory Lending FDIC’s Supervisory Policy on Predatory Lending, supra note 3, at 3 (“For the $325 loan, the lender charges $55 . . . .”); Uriah King, Wei Li, Delvin Davis, & Keith Ernst, supra note 31, at 3 (“On a $300 payday loan, a borrower typically incurs $45 in fees and receives $255 in cash.”).

36 The finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit. It does not include any charge of a type payable in a comparable cash transaction. Regulation Z, 12 C.F.R. § 226.4(a) (Westlaw current through May 6, 2010).

37 See Spector, supra note 31, at 962 (providing an example of the payday loan fee translated to an annual percentage rate).

38 See id. at 962 (finding “one study of APRs on similar transactions to be as high as 910%.”); Goulet, supra note 33, at 83 (“[Payday loan fees represent] an annual interest rate of 300-400%”); Megan S. Knize, Payday Lending in Louisiana, Mississippi, and Arkansas: Toward Effective Protections for Borrowers, 69 LA. L. REV. 317, 319-20 (2009) (“For the $325 loan, the lender charges $55, which works out to an Annualized Percentage Rate (“APR”) of 531%.”).

39 See Johnson, supra note 32, at 59 (“[T]he payday loan business model leads to the treadmill because it requires two-week terms . . ., it prohibits partial payments, and it requires payment of rollover fees to prevent default.”).
period, many, if not most, payday loan customers do not actually have the money to repay the principal balance at the end of that period. The customers often find that they need the money that would otherwise repay the loan to pay for basic necessities. One study has found that it is actually statistically impossible for the typical borrower to pay back a payday loan within two weeks.\textsuperscript{41} The typical payday loan customer takes out the loan due to an economic exigency, and because there is no other source of credit available to him or her.\textsuperscript{42} For a consumer faced with such an economic emergency, another study shows that it typically takes 90 days for the consumer to get back to financial stability after receiving the loan.\textsuperscript{43}

When coupled with the payday lender’s refusal to accept any partial principal payments, the customer’s inability to pay leads to the phenomenon of rollover. Rollover occurs when the customer, unable to repay the full principal and unwilling to fall into default if the payday lender attempts to cash her check, rolls the payday loan over for another pay cycle, again, typically two weeks.\textsuperscript{44} Because most customers cannot pay the principal even after one rollover, this leads to a debt cycle where the customer continues to accumulate rollover fees without reducing the principal debt owed, and without obtaining any additional funds.\textsuperscript{45} Studies show that the majority of payday loan customers end up in this debt cycle and enter into five to thirteen lending transactions per year, with most customers closer to thirteen.\textsuperscript{46}

2. Payday Lending as Predatory Lending

The bloated cost of credit to customers created by payday lending, and the destructive debt cycle that ensues, represent only a portion of the predatory nature of the payday lending industry. Payday lenders utilize numerous practices that are classified as predatory. In this section this article systematically applies the factors identified in section 2A, supra, to the common practices employed by the payday lending industry to demonstrate that individual payday loan transactions, as well as the industry as a whole, are predatory in nature.

\textsuperscript{41} See Knize, supra note 39, at 324 (“In fact, studies show that it is mathematically impossible for typical borrowers to repay payday loans in two weeks. In one study, a borrower making $25,000 a year would, without making payments on a loan, fall short $14 each week on recurring payments for food, housing, healthcare, transportation, and utilities. She would be unable to pay her loans without taking a second job – or a second loan.”); Johnson, supra note 32, at 59 (”The average payday loan customer earns only low-to-moderate income and, therefore, does not have sufficient disposable income to service debt.”).

\textsuperscript{42} See Spector, supra note 31, at 966-67 (“In short, the typical payday borrower does not have access to traditional credit outlets and often seeks a short-term loan because of a financial emergency, such as car repairs or medical expenses. But such emergencies are rarely short-term, and a single payday loan is rarely the solution.”).

\textsuperscript{43} See id.

\textsuperscript{44} See Johnson, supra note 32, at 56 (“A rollover normally means a customer’s payment of a fee to extend the payday loan’s due date for another two weeks.”).

\textsuperscript{45} See id. at 57; Spector, supra note 31, at 966.

\textsuperscript{46} See Spector, supra note 31, at 966; Johnson, supra note 32, at 58-59.
Recall that Professors Kathleen Engel and Patricia McCoy identified five basic problems associated with predatory lending in the mortgage market.\textsuperscript{47} These predatory practices included:

1. loans structured to result in seriously disproportionate net harm to borrowers,
2. harmful rent seeking,
3. loans involving fraud or deceptive practices,
4. other forms of lack of transparency in loans that are not actionable as fraud, and
5. loans that require borrowers to waive meaningful legal redress.\textsuperscript{48}

Also recall that Professor Kurt Eggert developed a comprehensive list of tools used by predatory mortgage lenders.\textsuperscript{49} While Professor Eggert’s list contained many practices applicable only to the mortgage lending industry, he also included factors that are relevant to analyze the predatory nature of the payday lending industry. Those relevant factors include:

1. Fees and interest rates far greater than necessary to provide a reasonable return;
2. Flipping, which is the early or frequent refinancing of a loan (analogous to the payday loan industry practice of “rollover” discussed in section IA, infra.);
3. High pressure and misleading sales and marketing techniques; and
4. Excessive prepayment penalties (analogously referred to as the “anti-payment” penalty in the payday loan industry discussed in section IA, infra).\textsuperscript{50}

It should be noted that some of the categories from both lists are duplicative and will be addressed together in the analysis that follows. For example, number one from both lists are sufficiently similar that an analysis of the activities represented by both those factors are combined.\textsuperscript{51} Likewise, Engel and McCoy’s third and fourth factors are similar to Eggert’s third factor and are combined in one category below.\textsuperscript{52} Additionally, some of the common practices linked to one payday lending predatory act cross over into multiple other predatory lending categories analyzed.

\textsuperscript{47} Engle & McCoy, supra note 5, at 1260.
\textsuperscript{48} Id.
\textsuperscript{49} Eggert, supra note 2, at 514-19.
\textsuperscript{50} Id.
\textsuperscript{51} Compare Engle and McCoy, supra note 5, at 1260 (“loans structured to result in seriously disproportionate net harm to borrowers”), with Eggert, supra note 2, at 514 (“Fees and Interest Rates Far Greater than Necessary to Provide a Reasonable . . . Return”).
\textsuperscript{52} Compare Engle and McCoy, supra note 5, at 1260 (“(3) loans involving fraud or deceptive practices; (4) other forms of lack of transparency in loans that are not actionable as fraud”), with Eggert, supra note 2, at 515 (“High Pressure and Misleading Sales and Marketing Techniques”).
i. Disproportionate Net Harm to Borrowers and Fees Greater than Necessary to Provide a Reasonable Return

First and foremost, the inflated APR that reflects the payday loan fee is the most illustrative practice employed by the payday loan industry that brings the industry within the predatory lending category. As discussed in section IIB1, infra, payday loans commonly start with an APR of around 400%. Depending on the particular lender, that APR can be even higher. Even in jurisdictions that attempt to control payday lending by strict statutory regulation, the starting APR for payday loans remains near 390%. This excessively high APR is far more than necessary to provide a reasonable return and greatly harms the borrower who cannot afford to pay such a high interest rate.

While proponents of the industry’s practice of charging such high APRs argue that the rates reflect the heightened risk of loss to the payday lender due to the type of customer that they lend to, the high profits realized by the payday lending industry undercut this argument. The payday lending industry generates 90% of its revenue from the interest and fees it charges its customers. In 2007, this revenue aggregated into a staggering $8.6 billion dollars in fees, relative to almost $50 billion of loans.

The disproportionate harm to the borrower is compounded exponentially by the industry practice of refusing to accept partial payment towards reducing the principal debt, thus leading to the rollover of the loan. For example, in one typical rollover case, a payday loan customer borrowed $300 from a payday lender, but ended up paying $1800 in rollover fees once she was sucked into the payday loan debt treadmill. To increase the already predatory nature of the transaction, the customer also entered into a bank debit agreement with the payday lender that enabled the lender to simply debit her bank account the rollover fee every two weeks.

53 See Spector, supra note 31, at 962; Goulet, supra note 33, at 83.
54 See Spector, supra note 31, at 962.
57 See Knize, supra note 39, at 322.
58 See id. (“A whopping 90% of the revenue generated in the payday lending industry comes from interest and other fees charged by [lenders]. In 2007, payday lenders collected $8.6 billion dollars in fees from American families borrowing nearly $50 billion dollars in loans.” (internal citations omitted)).
59 See Johnson, supra note 32, at 59.
60 See id. at 11 (“[F]or almost a year, National Money Service debited Ortega’s bank account every two weeks in the amount of $90 as interest to “roll over” the loan . . . . Because none of the $90 in interest payments counted as principal, Ortega still owed National Money Service $300 even though she had paid $1800 in interest charges.” (citing Adam Geller, Payday May Day:Short-Term Lenders Under Fire, HOUS. CHRON., Jan. 26, 2001, at B1)).
61 See id.
Worse than authorizing automatic bank debits is wage assignment, an increasingly popular method of payment used by payday lenders where a borrower voluntarily authorizes her employer to pay a lender directly from her wages. Wage assignments harm borrowers because the interest given to the payday lender from the borrower’s wages puts the payday lender ahead of even the customer’s secured creditors. For example, if a customer has a mortgage or auto loan payment to make, the payday lender gets paid first, directly out of the customer’s wages before the customer has the chance, or the choice, to pay other creditors that have a security interest in the customer’s property. This leads to a higher likelihood that borrowers will default on either their mortgage or auto loan.

Lastly, a payday lender has debt collection options that a borrower would not normally be subjected to in a typical loan transaction. Under civil bad check statutes in many states, a payday lender can sue for treble damages rather than just the cost of the loan and other associated collection costs. Not only is this harm to a delinquent borrower disproportionate to the cost incurred by the payday lender, in cases where the lender collects, it leads to a windfall.

\textit{ii. Harmful Rent Seeking}

Harmful rent seeking occurs “when subprime lenders use their market power to charge rates and fees that exceed the rates and fees they would obtain in a competitive market, they extract harmful rents from borrowers. Such rent-seeking is another common feature of predatory lending.” The term also includes padding a transaction with excessive, hidden or deceptive fees. The payday lending industry engages in harmful rent seeking on two levels. On the first level, the industry uses its market power to charge excessive fees, fees that are higher than what borrower would pay in a more traditional lending transaction. This rent-seeking tactic appears, at first, to be undermined by two arguments. First, the traditional customers of the payday lender often do not have access to traditional forms of financing. Second, the fact that there are so many payday lending storefronts across the country demonstrates that payday lending is actually a highly competitive market.

However, the both points can be at least initially addressed by the argument that because the payday lending industry is apparently targeting particular groups, inferentially these groups could be categorized as a captive audience with little or no choice as to where to obtain a loan.

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62 See MONGISGNOR JOHN EGAN CAMPAIGN FOR PAYDAY LOAN REFORM, supra note 55, at 9.
63 See id.
64 See id.
65 See id.
66 See id.
67 See id.
68 See id.
69 See id.
70 See id.
71 See id.
72 See id.
73 See id.
74 See id.
75 See id.
76 See id.
77 See id.
78 See id.
79 See id.
Furthermore, excessive rent seeking is not merely limited to this competitive aspect, but also includes padding a transaction with excessive, hidden or deceptive fees. The general APRs charged by payday lenders, coupled with the resultant APRs from excessive rollover fees meets this portion of the definition of excessive rent seeking.

iii. Fraud, Deception, Lack of Transparency, and Misleading Sales and Marketing Techniques

Throughout the life of the payday loan transaction, the payday lending industry’s practices include many tactics and strategies that fall into categories of fraud, deception, lack of transparency, and misleading sales and marketing techniques. The nature of these practices varies from outright illegal, to more deceptively devious marketing techniques, and remarkably aggressive and harmful collection methods.

One commonly used tactic among the payday lending industry that is, at the very least, deceptive, is “affinity marketing.” Affinity marketing schemes are designed to mislead customers into thinking that the products offered are sanctioned by an entity or the government. For example, the payday lending industry regularly targets military personnel for their fringe banking products. The payday lenders located around military bases engage in affinity marketing strategies to lure military customers into payday loan transactions. These techniques include placing advertisements in private publications, such as Army Times, which many service members perceive to be official military publications. The advertisements contain official looking seals designed to emulate military seals, and are often distributed by retired service members hired by payday lenders to sell loan services to military members. These affinity marketing techniques lead military service members to mistakenly believe that the loans and products offered by the payday lenders are endorsed by the military, or at least in some way vetted by the military.

69 See Goulet, supra note 33, at 85.
70 See id.
72 See Goulet, supra note 33, at 85 (“Payday lenders target military personnel by setting up shop around bases, and by employing ‘affinity marketing’ tactics to mislead service members into believing their loans are sanctioned by the United States government.”).
73 See id.
74 See id.
Another less-than-admirable strategy employed by payday lenders is to induce the borrower to enter into alternative lending transactions that are designed to skirt, or even break, the laws attempting to regulate the payday lending industry. These alternative lending practices include the sale-leaseback transaction, the cash catalog sale, and cash-back advertising. The sale-leaseback transaction is written up as though the lender buys an appliance from the customer. The lender then leases the appliance back to the customer for a rental fee until the customer repurchases the appliance. However, the lender never actually takes possession of the appliance, but rather takes a post-dated check from the customer. As part of the sale-leaseback transaction, if the customer defaults, the lender does not accept the appliance to satisfy the debt. Rather, the lender requires the customer to pay a lease renewal fee that deceptively serves the same function as the rollover fee.

In several states, payday lenders retain cash catalog sale and cash-back advertising companies that serve deceptive and fraudulent functions in the payday loan industry. In the cash catalog sale transaction, the customer writes a check for the payday loan, and a portion of the amount paid is allocated to the purchase of catalog certificates, in place of a loan servicing fee. In the cash-back advertising transaction, the customer purchases advertising in a publication that is only circulated to the lender’s customers for, once again, a fee that serves the same function as the loan servicing fee. These alternative lending schemes clearly deceive the customer and have prompted many critics to charge that the payday lenders actively violate the Truth in Lending Act. The deception and lack of transparency engrained in the transaction process is also evident in the collection practices adopted by the payday loan industry. Payday lenders enjoy debt collection

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75 See Johnson, supra note 32, at 19 (“[The] Consumer Union found that fourteen out if the twenty-one companies surveyed offered sale-leaseback services and ten out of those fourteen specifically claimed the service was ‘not a loan.’” (citing Ruth Cardella, Wolf in Sheep’s Clothing: Payday Loans Disguise Illegal Lending, CONSUMER’S UNION, at 3 (Feb. 1999) <www.consumer.org/pdf/paydayloans.pdf> ).
76 See Johnson, supra note 32, at 18.
77 See id. at 18.
78 See id. at 18-19.
79 See id. at 19.
80 See id.
81 See id. at 20 (“When the loan becomes due, the catalog company cashes the check and gives the borrower the certificates. In theory, the borrower may then use the certificates to purchase merchandise from the company’s catalog. In Cashback Catalog Sales v. Price, however, the court noted that the certificates at issue could only be used to purchase items from a mail-order catalog that was never given to the consumer.”).
82 See id. at 20-21 (“Consumers needing cash can go to the nearest cash-back advertisement company in the loan section of the yellow pages and go there to borrow $100 by purchasing an advertisement for publication and paying a $33 advertisement fee. Usually, the consumer has nothing to advertise; however, companies insist upon the purchase of an advertisement before distributing any cash. These ads are then placed in a publication distributed by the lender to its customers.”).
83 See id. at 18. (“Critics claim that, besides violating TILA, these lenders violate state laws by not complying with state usury limits, by failing to obtain licenses to issue consumer loans, by failing to pay state and local taxes, and by failing to comply with state credit disclosure requirements.”).
options that traditional debt collectors cannot employ, like criminal and civil remedies made available in many jurisdictions by various bad check statutes. Under the criminal bad check statutes, the payday lender can scare customers into paying their debts in order to avoid prosecution. In this way, payday lenders “use the threat of jail just as a loan shark might have used the threat of physical violence.” In many cases, though, payday lenders do not limit their activity to mere threats, they resort to criminal prosecution. In one jurisdiction alone, and in just one year, payday lenders filed 13,000 criminal complaints with law enforcement officials against their customers.

The collection practices of payday lenders under civil statutes are equally troubling. Payday lenders often place a hold on a borrower’s checking account as an enforcement tool. And as noted previously, unlike regular consumer debt, payday loan debt is the only type of consumer debt that can generate treble damage penalties based on the civil bad check laws in many states. Additionally, some payday lenders have filed collection suits in counties far from where the defendant-customer lives, making it difficult, if not impossible, for the customer to respond to the suit. A payday loan customer often incurs further injury when his or her bank opts to close the customer’s account when the customer defaults on his or her payday loan. When the customer attempts to open an account at another bank, he or she could be further disadvantaged because many banks refuse to open accounts for people whose previous banks have closed their accounts. Once undertaking a payday loan transaction, “the payday loan experience may turn a ‘banked’ customer into one of the ‘unbanked.’” This result is particularly problematic given the normal payday loan customer’s precarious financial position.

iv. Loan Flipping (Rollover)

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84 See Bertics, supra note 66, at 140.
87 See Drysdale & Keest, supra note 71, at 610.
88 See Moss, supra note 86, at 1731.
89 See Drysdale & Keest, supra note 71, at 611-12 (“Thus a [payday] lender might seek judgment for repayment of the principal and interest, the regular bounced check fees, triple the check amount as a penalty, and perhaps other collection fees.”).
91 See Drysdale & Keest, supra note 71, at 606.
92 Id.
Rollover occurs when a borrower engages in multiple loans over the life of a single payday lending transaction. As discussed in section IIB above, rollovers originate because the payday lending industry refuses to allow customers to pay down their debt by making partial payments on the principal. Rollover in the payday lending context is analogous mortgage loan flipping. In the predatory mortgage lending circumstance, loan flipping occurs when a mortgage is refinanced multiple times, adding additional fees and charges that the mortgagor is then responsible for. Rollover is similar to mortgage loan flipping because of the excessive fees that the practice generates, and the profit that payday lenders realize from those fees.

Payday lenders also engage in predatory lending practices that are directly comparable to mortgage loan flipping. In order to avoid violating industry guidelines, or statutes, that limit the number of rollovers a customer can incur in a single loan transaction, payday lenders simply refinance the loan with a new loan, thus “flipping” the loan. An accurate definition of “rollover” should broadly cover this type of re-financing lending transaction, in addition to the well-accepted definition that involves paying renewal fees.

v. Excessive Prepayment Penalty as the “Anti-Payment” Penalty

The practice that denies the payday loan customer the option to make partial payments on the principal, which leads to a loan rollover, is what I call the “Anti-Payment” penalty. In the predatory home-lending transaction, a mortgage will likely have an excessive prepayment penalty associated with it. This serves the following two functions: first, if the lender anticipates that the loan will have a shorter duration, as many subprime loans do, then it ensures a tidy fee for the predatory lender when the home buyer flips the loan; and second, it deters the consumer from repaying the loan too soon, which ensures a certain level of profit for the lender.  

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93 See Spector, supra note 31, at 967.
94 See Johnson, supra note 32, at 11.
95 See Eggert, supra note 2, at 515 (“Flipping is the early or frequent refinancing of a loan, normally with each new set of loan fees financed by the loan, so that the loan amount continually rises, even while the homeowner makes her payments. . . . Some lenders accomplish flipping by requiring their borrowers whose loans become delinquent to refinance the loans in order to bring them current . . . .”).
96 See Goulet, supra note 33, at 87 (discussing the payday loan industry’s own national trade association, the Community Financial Services Association (CFSA), and its attempts to address concerns about payday lending and the military by issuing its “Military Best Practices” guidelines: “Although these guidelines claim to ‘limit rollovers to four (4) or the State limit, whichever is less,’ loan flipping has continued through back-to-back transactions, in which the lender allows the customer to close out the old loan and then immediately re-open a new loan to bypass the rollover limitation”).
97 See Johnson, supra note 32, at 56-57 (“[R]ollovers should be defined more broadly to encompass not only the straightforward practice of paying a renewal fee but also the practice of refinancing a loan by taking out a ‘new loan’ from the same payday lender to pay off the ‘old loan’ with the proceeds from the new.”).
98 See Eggert, supra note 2, at 518. (“In practice, when employed by predatory lenders, prepayment penalties are designed to either trap the borrower, forcing her to remain in an inequitable loan, or to reward the lender with an unreasonable payoff when an unwitting borrower refinances the loan.”).
In the payday loan context, the anti-payment penalty roughly serves the same two purposes. First, when a consumer cannot repay the loan, the loan rolls over and a fee is collected by the payday lender. Second, rather than serving as a deterrent to early payment, like it does in the home lending transaction, the anti-payment penalty makes it virtually impossible for many consumers to make the full payday loan payment. This again ensures a significant profit for the payday lender from the consumer who must rollover her loan.

vi. Waiver of Meaningful Legal Redress

Many payday lenders incorporate mandatory binding arbitration agreements into payday lending contracts in order to eliminate any meaningful avenue of legal redress available to the borrower. Every payday lending agreement that the author has obtained in conducting research for this article contains a binding arbitration agreement. As argued in Section IV, infra, these agreements deny the payday lending customer the opportunity to have her case heard in court, and, as argued below, may indicate that the payday lending industry targets and takes advantage of entire classes of customers.

C. Payday Lenders Deliberately Target Minority Customers

Advocates for the payday lending industry claim that, when payday lenders market their fringe banking products, they do not target any specific class of customers. However, the evidence suggests that this claim is not true. Studies provide overwhelming evidence that the payday lending industry does, in fact, target minority customers, predominantly those with African American and Hispanic backgrounds. Of these two groups of customers, payday lenders target African American customers in particular. In addition to these two racial groups, there is strong evidence that payday lenders target members of the military. The significance of this fact will be analyzed in section IV, in a discussion about the failure of the government to effectively regulate the payday lending industry.

In general, it is apparent that payday lenders know their most profitable customer base and market directly to them. These lenders seek out financially disadvantaged customers who lack economic sophistication; then the lenders sell these customers products that they do not need and cannot afford. Payday lenders find these customers largely in minority neighborhoods;

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100 See Knize, supra note 39, at 322; see also supra text accompanying note 58.
101 [Perhaps write the specific language from one of the agreements here].
103 See Knize, supra note 39, at 325. (“Payday lenders know where to find their desired customers: economically disadvantaged areas, towns near military bases, and minority neighborhoods.”).
104 See id.
therefore, the lenders establish storefronts in these neighborhoods in numbers disproportionate to
other types of lending institutions. Illustrative of this fact are the business plans developed by
payday lenders that specifically promote targeting migrant workers and welfare recipients that
are entering into the workforce. African Americans, in particular, account for a significant
portion of the payday lending customer base, and payday lenders make strong efforts to reach out
to the African American community.

Studies and surveys by various governmental agencies and independent organizations lend
strong support to the assertion that the payday lending industry targets minority customers.
These surveys and studies repeatedly and consistently demonstrate that payday lenders are
actively targeting and marketing to minority customers, with a strong bias towards African
Americans. The Survey of Consumer Finances (“SCF”) is a triennial survey conducted by the
Federal Reserve Board, designed to capture data relevant to the financial characteristics of
American families. For the first time in 2007, the SCF gathered data (and released the data in
February 2009) about the use of payday lenders by respondents. The SCF data illustrates “that
minorities disproportionately utilized payday lenders in 2007.” The data also indicates that
African Americans “make up a larger share of payday customers than of the general
population.”

Although one can infer predatory targeting based on the racial composition of the payday lending
industry’s customer base, this alone does not prove that payday lenders are actually targeting
minority customers. Fortunately, there are a significant number of other studies that illuminate
the payday lending industry’s practice of targeting minorities. One such study was recently
published by the Center for Responsible Lending, entitled Predatory Profiling: The Role of Race

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105 See Michael Stegman, The Public Policy Challenges of Payday Lending, 66 INST. OF GOV. AT THE U. OF
N.C. AT CHAPEL HILL 16, 17 (Spring 2001) (citing research the author conducted regarding the location of
payday lending storefronts: “We found that check cashers and payday lenders are not scattered throughout the city,
but are more likely to locate in high-minority and working-class neighborhoods. Relative to population, there are
one-third as many banking offices and more than four times as many check-cashing offices in high-minority
neighborhoods as in low-minority neighborhoods”).

106 See CTR. FOR RESPONSIBLE LENDING, Fact v. Fiction: The Truth About Payday Lending Industry Claims,
at 1 (Jan. 1, 2001) <http://www.responsiblelending.org> (citing two payday lending business plans that target
discreet sections of the population: “There are 40 million American households with incomes of $25,000 or less that
need convenient check cashing [and] quick availability of micro loans between $50 and $300 . . . . Moreover, this
market is expected to grow over the next decade; especially those households that are leaving the roles of welfare for
employment. . . . Time of year is important . . . Tax season and Xmas offer [more payday loan] activity; summers can
be slower but could be greater if your community grows with migrant workers”).

107 See Sheila Bair, Low-Cost Payday Loans: Opportunities and Obstacles, ISENBERG SCH. OF MGT. U. OF
MASS. AT AMHERST, at 8 (June 2005) (“Indeed, payday industry leaders have made a concerted effort to reach out
to the African-American community through, for instance, financial education initiatives, and partnerships with
traditionally black colleges.”).


109 See id.

110 Id. at 7.

111 Id.
The primary objective of the study was to determine what role race and ethnicity play in the location of payday lending storefronts. The study noted, as indicated above, that African Americans and Latinos in California represent a disproportionately greater number of payday borrowers. This disproportionate composition of the payday lender’s market share is made more significant by the “fact that African Americans and Latinos are much less likely to have a checking account than whites – a basic requirement for getting a payday loan.” Also citing data from the Federal Reserve Board’s SCF, the Center for Responsible Lending’s report points out that, although one in five African American or Latino residents don’t have a checking account, as compared with only 5% of white residents, they are still a disproportionately large portion of the California payday lending industry’s customer base. The report states:

While less than five percent of payday loan-eligible adults in California are African American, they make up 18.7 percent of all payday borrowers. Similarly, 25.6 percent of payday loan-eligible adults are Latino, but they represent about 37 percent of payday borrowers. In contrast, white borrowers represent 44.5 percent of the eligible population, but just 36 percent of borrowers.

The study found that payday lender locations are nearly eight times more concentrated in African American and Latino neighborhoods than white neighborhoods. The high concentration of payday lenders in these neighborhoods enables the lenders to take nearly $247 million a year in fees from the communities’ residents. Furthermore, even after factoring in controlling variables like income, payday lenders are 2.4 times more concentrated in African American and Latino communities. Moreover, on average, the payday lender nearest the center of an African American or Latino neighborhood is almost two times closer than in largely white neighborhoods.

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113 See id. at 7.
114 See id. at 4 (“In California and elsewhere, a disproportionate share of payday borrowers come from communities of color. The California Department of Corporations recently released a survey of payday borrowers showing that, while they represent about a third of the overall adult population, over half of payday borrowers are African American or Latino.” (internal citations omitted)).
115 Id.
116 See id.
117 Id.
118 Id. at 10 (“Not only are payday lending storefronts located in or closer to communities of color, payday lenders also tend to cluster in these areas, with more stores in a given African American and Latino neighborhood than a neighborhood with a greater share of white households. Payday lenders are nearly eight times as concentrate in neighborhoods with the largest share of African American and Latinos as areas with the lowest concentration of these groups.”).
119 See id. at 12 (“This clustering of payday lending storefronts results in the draining of nearly $247 million in fees from African American and Latino households in California.”).
The study indicated that “payday lenders tend to locate in closer proximity to neighborhoods with a higher proportion of people of color, renters, adults, lower educational attainment, and non-English speakers.”\textsuperscript{120}

One study that researched the location of payday lenders in eight Illinois and Louisiana counties yielded similar results, finding that “payday lenders are locating in neighborhoods that are poorer and have higher concentrations of minorities than their county of location as a whole.”\textsuperscript{122} The study concluded that significant evidence suggests that the “payday lending industry is targeting neighborhoods with a higher percentage of poor and minority residents.”\textsuperscript{121}

Research in other regions of the country bears the same result: payday lenders actively seek out minority customer bases around the country. In North Carolina, for example, a study showed that there were four times as many payday lending offices in minority neighborhoods.\textsuperscript{124} This results in a much higher likelihood that low-income African American families in North Carolina would take out a payday loan.\textsuperscript{125} Another North Carolina study found that there were at least three times as many payday loan outlets per capita in African American neighborhoods than in white neighborhoods.\textsuperscript{126} A study that mapped the locations of payday lending storefronts in Pima County Arizona found that “37% of Pay Day Loan locations . . . lie within $\frac{1}{4}$ mile of areas with a high percentage of Latinos.”\textsuperscript{127} Additionally, a statistical analysis of payday lender locations in the state of Washington determined that payday lenders are “deliberately targeting African-American population centers . . .”.\textsuperscript{128} Research conducted by the Woodstock Institute in

\begin{itemize}
\item \textsuperscript{120} See id. at 14: “Our analysis demonstrates that payday lenders cluster in closer proximity to neighborhoods with the greatest concentration of African American and Latinos, and that this proximity exists even when controlling for a wide variety of demographic and economic variables. This is likely the key reason that African Americans and Latinos make up a disproportionate share of total payday borrowers.” Id. at 23.
\item \textsuperscript{121} Id. at 14.
\item \textsuperscript{122} Steven M. Graves, Landscapes of Predation, Landscapes of Neglect: A Location Analysis of Payday Lenders and Banks, 55 CAL. ST. U. NORTHRIDGE 303, 311. (Aug. 2003).
\item \textsuperscript{123} Id. at 312.
\item \textsuperscript{124} See Michael A. Stegman & Robert Faris, Payday Lending: A Business Model that Encourages Chronic Borrowing, 17 ECON. DEV. Q. 8, 13 (2003) (“These banks also disproportionately favored high-minority neighborhoods. Relative to population, there were one third as many banking offices and more than four times as many check-cashing offices in neighborhoods that were at least 70% minority as in neighborhoods that were less than 10% minority.” (internal citations omitted)).
\item \textsuperscript{125} See id. at 17 (“[T]he model confirms that lower income African American families in North Carolina are more than twice as likely to have taken out a payday loan in the past 2 years than have White non-Hispanic families.”).
\item \textsuperscript{126} See King, Li, Davis, & Ernst, supra note 31, at 2 (“African-American neighborhoods have three times as many [payday lending] stores per capita as white neighborhoods. This disparity increases as the proportion of African-Americans in a neighborhood increases.”).
\item \textsuperscript{127} Amanda Sapir & Karin Uhlich, Pay Day Lending in Pima County Arizona, S.W CTR. FOR ECON. INTEGRITY, at 11 (Dec. 2003).
\item \textsuperscript{128} Oron, supra note 102, at 19 (“Therefore I conclude that from my analysis emerges a clear pattern of ‘pay-days’ deliberately targeting African-American population centers in Washington State. As mentioned earlier, these localities also have disproportionately large numbers of other nonwhite ethnic groups, and other vulnerable social groups, which may also be perceived as ‘pay-day’ targets. However, on the Census-defined racial category level, only blacks emerge as a clear-cut target. They are, so to speak, the ‘spotted owls’ of social statistics.” (emphasis added)).
\end{itemize}
Illinois also found that “communities with a majority minority population have a higher rate of payday loan stores.”

The collection practices of payday lenders lends further support to the argument that payday lending storefronts are located disproportionately in predominantly minority neighborhoods. In the study Hunting Down the Payday Loan Customer: The Debt Collection Practices of Two Payday Loan Companies, the study analyzed court filings about payday lenders’ attempts to collect payday loans that were in default. The findings showed that nearly 70% of defaulting customers who borrowed from Americash with pending or completed court cases were located in predominantly minority ZIP codes, marked by low- or moderate-income, and with “nearly 90 percent of cases located in predominately minority communities of any income.”

While it is important to take into account other variables, such as unemployment and poverty rates when determining the significance of such a figure, the fact that 90% of the collection cases occurred in mostly minority ZIP codes strongly suggests a heightened presence of payday lending storefronts in those ZIP codes.

The implication from the multiple payday lending studies is clear. The payday lending industry deliberately targets minority customers, and African American customers appear to be the minority of choice worth targeting. When the exceptionally harmful and predatory nature of the payday lending industry is coupled with the industry’s marketing strategies that target minority customers, an ominous reality for this class is clear: the dangers and harms of payday loans are disproportionately allocated towards minorities, just as the profits of this predatory industry are disproportionately extracted from the minority customer base.

III. The Use of Consumer Arbitration Agreements by the Payday Lending Industry

Arbitration agreements in consumer contracts are a relatively new phenomenon in the law. These agreements were introduced in the 1990s primarily by the credit card industry. The turn of the century saw an explosive rise in the use of consumer arbitration agreements and now virtually every consumer is subject to multiple arbitration agreements through credit cards, cellular phone plans, and a host of other consumer-oriented services.

130 MONSIGNOR JOHN EGAN CAMPAIGN FOR PAYDAY LOAN REFORM, supra note 55.
131 Id. at 6 (emphasis added). See also MONSIGNOR JOHN EGAN CAMPAIGN FOR PAYDAY LOAN REFORM, WOODSTOCK INST., Greed: An In-depth Study of the Debt Collection Practices, Interest Rates, and Customer Base of a Major Illinois Payday Lender, at 9 (Mar. 2000) (“[C]ustomers sued by Americash are overwhelmingly located in areas that are over 75% ethnic minority.”).
132 See Stephen J. Ware, Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements, 2001 J. DISP. RESOL. 89, 89-90 (“Relative to litigation, arbitration provides opportunities for a business to save on its dispute resolution costs.”).
Just as the use of arbitration agreements proliferated through various consumer service providers, the payday lending industry adopted the practice as well. I have personally obtained payday lending agreements from three payday lenders and each one contains an arbitration agreement.

The use of arbitration agreements by the payday loan industry is problematic for several reasons. The predatory nature of the industry, the vulnerable populations, particularly minorities that the industry targets, and the complicated nature of some of these arbitration agreements, are reasons that militate strongly against their use by the payday loan industry. This section of the article will analyze the use of arbitration agreements by the payday loan industry. It will begin with a broad overview of the debate surrounding the use of consumer arbitration agreements, and then analyze the use of such agreements by the payday loan industry specifically. This section concludes with the argument that the use of arbitration agreements by the payday loan industry insulates and furthers the industry’s discriminatory practices.

A. The Debate over Consumer Arbitration Agreements

The use of consumer arbitration agreements is the subject of significant debate in industry, advocacy groups, academia, and the judiciary. Those in favor of such agreements tend to be pro-business, freedom-of-contract advocates; those opposed are generally advocates for consumers. While there is merit to arguments on both sides of the debate, this article argues that, ultimately, consumer arbitration agreements present too high of a risk of loss of effective avenues of redress for consumers in general. Specifically, in the payday lending arena, the agreements are especially nefarious legal tools that permit payday lenders to further their discriminatory predatory practices.

I have previously argued that the main benefits of consumer arbitration agreements, as perceived by consumer-related industries, are increased efficiency in dispute resolution and the reduction of risk exposure to consumer legal claims. The common belief is that arbitration agreements are appealing to consumer industries because they reduce the overall cost of litigation to a company, as well as effectively reduce the time it takes to reach a legal resolution of a claim. Compared to the procedures embodied in the civil procedure rules in various jurisdictions, the procedures for arbitrating a claim are fairly streamlined. This is one important factor that

leads to the reduction of time and costs of using arbitration rather than instituting an action in court.

Another efficiency gained through arbitration is the ability to nurture and identify regional pools of arbitrators educated in the type of consumer transaction that a company is likely to bring to arbitration. These arbitrators are more likely to be experienced practitioners within the particular area of law where the arbitration claim falls. Additionally, this limited pool of experienced arbitrators creates a repeat-player effect that benefits the companies seeking arbitration in two ways. First, the company has the opportunity to educate several arbitrators in a regional pool about the specific consumer transaction at issue. As the arbitrators become more educated, the arbitrations become more efficient because the time it takes to educate a particular arbitrator about the specifics of the transaction at issue is reduced. Second, the company itself has the opportunity to gauge how the individual repeat-player arbitrators perform in a given region. The company can then, in effect, educate itself on the positive or negative outcomes of cases arbitrated in front of certain arbitrators and choose its arbitrators accordingly. There is no doubt that business-savvy arbitrators with a pecuniary interest in repeat business are likewise benefited by this repeat-player phenomenon.

In addition to efficiency, another reason consumer businesses perceive arbitration as advantageous is the mitigation of the risk of loss that arbitration and arbitration agreements can provide. The primary benefit here is the reduction of runaway jury verdicts that the repeat-player phenomenon ensures. By placing the outcome of an arbitration case in the hands of an

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136 See Carrie Menkel-Meadow, Do the “Haves” Come Out Ahead In Alternative Judicial Systems?: Repeat Players in ADR, 15 OHIO ST. J. ON DISP. RESOL. 19, 36 (1999) (stating that when selecting an arbitrator from arbitration service providers, “[d]isputants also may choose from private rosters of repeat play third party neutrals. . .”).
137 See Broome, supra note 134, at 41 (asserting that the “repeated use of an arbitral forum generates institutional knowledge over a particular subject matter and enhances the forum’s ability to resolve a company’s disputes as efficiently as possible”).
138 See id.
139 This second opportunity depends upon the specific rules of the arbitration provider being used. For example, under the AAA rules, a company will be able to employ a method similar to a peremptory strike against an arbitrator that has ruled unfavorably in the past. However, under the NAF rules, the arbitrator will be assigned by the NAF and the business can use one strike, and then must rely upon disqualification requests. Compare AAA Com. Arb. R. & Mediation P., R-11 (2009), available at http://www.adr.org/sp.asp?id=22440#R11 (“(a) If the parties have not appointed an arbitrator . . ., the arbitrator shall be appointed in the following manner: The AAA shall send simultaneously to each party to the dispute an identical list of 10 . . . names of persons chosen from the National Roster. The parties are encouraged to agree to an arbitrator from the submitted list and to advise the AAA of their agreement. (b) If the parties are unable to agree upon an arbitrator, each party to the dispute shall have 15 days from the transmittal date in which to strike names objected to, number the remaining names in order of preference, and return the list to the AAA.”) (emphasis added), with Natl. Arb. Forum Code of P. R. 21C (2008), available at http://www.arb-forum.com/main.aspx?itemID=609&hideBar=False&navID=162&news=3 (“For Common Claim Hearings, the Forum shall submit one arbitrator candidate to all Parties making an Appearance. A party making an Appearance may remove one Arbitrator Candidate by filing a notice of removal with the Forum . . . . A Party making an Appearance may request disqualification of any subsequent Arbitrator in accord with Rule 23.”) (emphasis added).
arbitrator that is educated in that field, and is motivated to be rehired as a future arbitrator, companies feel that this reduces the risk of a disproportionately high award to a victorious consumer.\textsuperscript{141} Limiting the use of civil procedure also yields a cost-savings opportunity in arbitration.\textsuperscript{142} Discovery in arbitration is often non-existent, or at least severely limited, compared to a court case.\textsuperscript{143} This leads to savings, or reduction of risk, from two avenues: the expense of discovery is greatly reduced, and the consumer is often unable to obtain documents in support of her claim against the company, weakening her ability to prove, and thus win, her arbitration claim.

Arbitration also mitigates loss because, as a side effect of many arbitration agreements, it deters consumers from bringing claims in the first place. The cost of filing an arbitration claim is often significantly more expensive than filing a claim in court.\textsuperscript{144} The expense of filing the arbitration case has the effect of deterring consumers from bringing such claims; indeed, consumers that can’t afford the filing costs upfront are not only deterred, but actually prevented from bringing their claims.\textsuperscript{145} Additionally, many arbitration agreements contain contractual provisions that provide that the losing party must pay the victor’s attorney’s fees and costs. Such provisions can have an in terrorem effect that strongly dissuades consumers with colorable claims from filing an arbitration claim out of fear that they will be required to pay the other side’s fees if the claim is unsuccessful.

\textsuperscript{141} See Ware, supra note 134, at 3 (arguing that arbitration benefits parties by allowing “their cases to be resolved by respected professionals who understand the nature and consequences of their rulings. Such arbitrators are unlikely to deliver off-the-wall verdicts sometimes issued by jurors”).

\textsuperscript{142} See Ware, supra note 132, at 90 (“[A]rbitration can reduce the amount of discovery available to consumer-plaintiffs, thus reducing the amount of time and money businesses must spend on the discovery process. . . .”).

\textsuperscript{143} See, e.g., AAA Com. Arb. R. & Mediation P. R-21 (2009), available at http://www.adr.org/sp.asp?id=22440#R21. The sole rule pertaining to discovery for arbitrations proceeding before the AAA is R-21, Exchange of Information:

(a) At the request of any party or at the discretion of the arbitrator, consistent with the expedited nature of arbitration, the arbitrator may direct:

(i) the production of documents and other information, and
(ii) the identification of any witnesses to be called.

(b) At least five business days prior to the hearing, the parties shall exchange copies of all exhibits they intend to submit at the hearing.

(c) The arbitrator is authorized to resolve any disputes concerning the exchange of information.

\textsuperscript{144} See Separate and Unequal Justice: The Case Against Binding Mandatory Arbitration for Homebuyers, CTR. FOR RESPONSIBLE LENDING, CRL Issue Paper No. 8, at 3 (Feb. 24, 2005) <www.responsiblelending.org> (the cost to file a claim valued at $150,000 in federal court is $150, which is comprised solely of the court filing fee. The cost to file the same claim with the National Arbitration Forum, comparatively, is $16,050.00. That cost comprised a filing fee, a fee to request amendment, subpoena, discovery order, time extension, continuance from arbiter, request for expedited hearing, 2 full days of hearings, a post-hearing memorandum, a written opinion with conclusions of law and a dispositive order. In short, in order to obtain the same “services” that one would expect from a court of law for a filing fee of $150, a consumer in an arbitration before NAF would need to pay over 100 times that amount).

\textsuperscript{145} See Ware, supra note 132, at 90 (“[A]rbitration can deter claims against businesses by requiring consumer-plaintiffs to pay arbitrator fees, as well as filing fees that exceed the filing fees in litigation.”).
Arbitration agreements also often contain class action waivers that deter law suits and significantly mitigate the company’s risk of loss associated with litigating, and perhaps losing, such a suit. The deterrent lies in the fact that the values of the individual claims that would comprise a class are not worth pursing on an individual level and thus would not be economically viable but for the class action mechanism. These waivers mitigate the risk that a company will face expensive and protracted class action litigation.

Finally, by using arbitration clauses, companies can reduce the risk of the loss of goodwill capital and lessen the burden of aggressive regulatory action. Arbitration agreements are, by definition, private. By resolving disputes privately, a company can avoid negative publicity otherwise garnered by the potential public display often generated in a court case. Additionally, a company can include a non-disclosure clause in the arbitration agreement that limits the ability of the parties to the arbitration to publicize the case. This privatization effect also benefits companies by increasing regulators' transaction costs to police the companies' collective activities by making it more difficult to obtain information about the companies' actions and practices. This in turn limits the exposure that a company might have to regulatory enforcement actions.

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146 See id. at 94 (stating that “some businesses use arbitration clauses in the hope that courts will enforce these clauses to preclude class actions.”); see John C. Coffee, Jr., Class Wars: The Dilemma of the Mass Tort Class Action, 95 COLUM. L. REV. 1343, 1349-50 (1995) (claiming that traditionally, “corporate defendants vigorously resisted the use of the mass tort class action, preferring even the alternative of bankruptcy reorganization.”); see Myriam Gilles, Opting Out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action, 104 MICH. L. REV. 373, 391-93 (2005) (generally describing the failure of judicial and legislative attempts to curtail class action litigation and the impetus this failure had in leading to class action waivers in mandatory arbitration agreements with consumers).

147 See Ware, supra note 132, at 93 (“Businesses can incur substantial liability in consumer class actions, both in cases that provide significant relief to the class and in cases that provide insignificant relief to the class but significant fees to plaintiffs’ lawyers.”); see also J. Maria Glover, Beyond Unconscionability: Class Action Waivers and Mandatory Arbitration Agreements, 59 VAND. L. REV. 1735, 46 (2006) (“Class action waivers are viewed by these companies as a way to defend themselves from consumers who are ganging up on companies through the leverage inherent in the aggregation of large numbers of claims.”).

148 See Ware, supra note 134, at 4 (arguing that one of the benefits of consumer arbitration is its confidential nature, which avoids “the prying eyes of business rivals, voyeur journalists, and lawyers who might stir up copycat lawsuits”).


150 See Ware, supra note 134, at 4 (The confidential nature of arbitration “is particularly valuable to parties who want their disputes resolved discretely. . .”).
The end result from the corporate perspective is that the improved efficiencies and cost-mitigating effects of arbitration agreements can significantly reduce the impact of civil lawsuits on day-to-day business operations. However, there is a powerful and growing voice of opposition to the use of such agreements in consumer transactions. As with many things in the law, the yin and yang of arbitration agreements is that what is very good for one side, namely the corporations, and has significant negative effects on the other side, the consumers. Because of the significance of these negative effects on consumers, many scholars and consumer advocates are pushing strongly for banning, or at least severely limiting, the use of arbitration agreements in consumer contracts.

The private nature of arbitration agreements that mitigate risks for businesses, simultaneously increases the risks to consumers and to society as a whole. By taking these disputes private, the benefits of public vigilance are lost, or at the very least severely restrained. For instance, even if mandatory arbitration were beneficial to consumers who brought claims, one could argue that “it would still be detrimental to society in that it curtails the use of public (sometimes jury) trials and eliminates the development of public precedent.” This critique, called the public justice critique, “is founded on the underlying principle that society as a whole benefits from the public exposition of the law.” The elimination of public resolution results in severely limited public awareness of issues involved in the dispute, and the ability of institutions charged with protecting the public is likewise limited.

Furthermore, consumers, both individually and as groups, are significantly weakened by the subjugation of their claims to the private dispute resolution system. From the individual consumer’s perspective, there is a significant increase in the transaction costs of obtaining information in a private dispute resolution system. First, an individual consumer would likely be unaware of a company’s pattern of conduct that systematically employs arbitration agreements. Second, with the limited discovery available in an arbitration proceeding, an individual consumer would be severely constrained in her ability to find out information needed to successfully pursue her claim.

The transaction cost problem is exponentially amplified when a class action waiver is included as a term of the consumer arbitration agreement. The very low value of most consumer claims

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151 Sternlight, supra note 140, at 1661.
152 Id.
153 See Separate and Unequal Justice: The Case Against Binding Mandatory Arbitration for Homebuyers, supra note 144, at 2 (criticizing the private nature of arbitration proceedings, this issue paper points out that “[t]his cloaked process means that patterns of misdeeds by lenders remain hidden. As a result, other homeowners are denied knowledge that might facilitate their claims, while unscrupulous lenders can continue unjust or illegal actions in relative safety”).
154 See Glover, supra note 147, at 1747 (arguing that the use of class action waivers in conjunction with mandatory binding arbitration allows businesses to continue corporate misbehavior).
155 See Ware, supra note 132, at 89.
begets the necessity of pooling consumer claims into a class action lawsuit in order to make individual recovery viable. Thus, consumers are major beneficiaries of the class action system. In fact, one of the theoretical underpinnings of the class action lawsuit is precisely that the claims are not valuable enough to be economically worth pursuing as individual claims.\(^{156}\) By pooling similar low-value claims together, the lawsuit becomes both economically viable and justified. By contractually limiting a consumer’s ability to be a member of a class in such a suit, an arbitration agreement virtually ensures that consumers with low-value claims cannot and will not pursue them against a company protected by the agreement.\(^{157}\)

More problems for consumers are apparent when one looks at the arbitration process itself. First, there is a serious loss-of-accountability problem that arises when a dispute is resolved in the arbitration process. Case law dictates that even if an arbitrator makes a legal error or decides a case improperly according to the law, a court must still confirm the arbitrator’s award.\(^{158}\) The status of the law, coupled with the fact that a typical arbitration agreement does not allow for, or severely limits the ability to appeal the decision of the arbitrator, almost completely removes any accountability that an arbitrator has to the parties in the arbitration and to the public for his or her decisions.\(^{159}\) By limiting the appeals process, both the procedural and substantive rights of consumers are placed at a high risk of injury.

The repeat-player phenomenon adds yet another layer of potential injustice to consumers subjected to arbitration agreements.\(^{160}\) The three interested parties in arbitration are the consumer, the company, and the arbitrator. Consumers are the one party in that group that is, in all likelihood, not a repeat player to the arbitration game. Consumers neither enter into enough transactions to engage in a significant number of arbitration proceeding, nor do they have sufficient monetary resources to do so. The business that is adverse to a consumer in arbitration, on the other hand, is more likely to enter into a large number of transactions that warrant multiple arbitrations, and is also likely to have the resources to fund such activity.\(^{161}\) Compounding the prejudice against consumers in arbitration is the typically small pool of arbitrators in a given region, within an even smaller pool of arbitration providers, who have the

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\(^{156}\) See Glover, supra note 147, at 1747.

\(^{157}\) See id.

\(^{158}\) See, e.g., Kyocera Corp. v. Prudential-Bache Trade Servs., 341 F.3d 987, 994 (9th Cir. 2003) (“Neither erroneous legal conclusions nor unsubstantiated factual findings justify federal court review of an arbitral award under the [Federal Arbitration Act] . . .”).

\(^{159}\) See generally Separate and Unequal Justice: The Case Against Binding Mandatory Arbitration for Homebuyers, supra note 144, at 4.

\(^{160}\) See Lisa B. Bingham, Employment Arbitration: The Repeat Player Effect, 1 EMPLOYEE RIGHTS & EMPL. POLICY J. 189, 210 (1997) (finding that employees who arbitrated disputes with employers before repeat-player arbitrators only recovered 11% of their claim, while employees facing non-repeat-player arbitrators recovered 48% of their claim).

Another concern raised by the repeat-player phenomenon is a product of the fact that arbitrators, and the arbitration providers that select them, have monetary interests at stake. Arbitrators are typically not paid by the organization under whose auspices an arbitration proceeding is being conducted [what does this mean—“organization”? The arbitration provider or the company in arbitration?]. Rather, the arbitrator collects his fee directly from the parties to the arbitration. This raises an obvious and pressing concern about an arbitrator’s potential bias in favor of the company that repeatedly procures the arbitrator’s services. The companies that provide arbitration services are the subject of the same bias concern because they too have a pecuniary interest in being selected multiple times as an arbitration provider, which is often ahead of time through a clause in the arbitration agreement itself. This bias is difficult to detect because in most cases statistical results for arbitration providers and specific arbitrators are not available. However, evidence from a California study of arbitrator bias indicates that arbitrators, arbitration providers, and companies utilizing arbitration do, in fact, all benefit from the repeat-player phenomenon to the detriment of consumers.

In sum, while there are logical reasons supporting a consumer-oriented business preference for using arbitration agreements, it seems that the harm, both actual and potential, to consumer and to societal interests outweighs the economic benefit gained by employing such agreements. These private dispute resolution agreements significantly and disproportionately favor corporate

162 Id. (finding in California, between January 1, 2003 and March 31, 2007, “eighty-four percent of the MBNA cases were decided by a small cadre of 27 NAF arbitrators. Another 116 arbitrators handled the remaining 16 percent, including 68 arbitrators who handled fewer than 10 cases”).
163 See id.
164 Satz, supra note 133, at 40.
165 See O’Donnell, supra note 161, at 30 (“[A]rbitrators are paid by the case. The more cases they handle, the more they get paid.”) (citing Depo. Edward C. Anderson (Sept. 29, 2003), for the case DeWayne Hubbert v. Dell Inc., 835 N.E.2d 113 (Ill. App. 2005)).
166 See id. at 29 (complaining that the arbitration process gives arbitrators “strong incentive to favor the arbitration companies’ clients”); Bingham, supra note 160; Ware, supra note 134, at 3 (arguing that one of arbitration’s advantages over a jury trial is that “[a]rbitrators know that their rulings must be sensible if they are to be invited to arbitrate in future cases”). Of course, if the consumer is not going to participate in arbitration proceedings very often, but a business is, the question then becomes whose sensibilities concern an arbitrator the most?
167 See O’Donnel, supra note 161, at 17 (describing that in California, between January 1, 2003 and March 31, 2007, “eighty-four percent of the MBNA cases were decided by a small cadre of 27 NAF arbitrators. Another 116 arbitrators handled the remaining 16 percent, including 68 arbitrators who handled fewer than 10 cases.”); id. at 15 (“Topping the list of [MBNA’s] arbitrators was Joseph Nardulli, who handled 1, 332 arbitrations and ruled for the corporate claimant an overwhelming 97 percent of the time.”).
interests, and, when used in a predatory manner, seriously undermine the social interests of society’s most disadvantaged members.

B. The Injustice of Mandatory Arbitration Agreements in Payday Lending Transactions

The payday lending industry is no different from other consumer industries when it comes to the prolific use of arbitration agreements as part of the payday consumer loan agreement. There have been court cases documenting their use, and all of the payday loan agreements that I obtained (three) contain arbitration agreements. While the benefits of arbitration to a predatory industry, such as the payday loan industry, are readily apparent, when one considers the arguments against their use in such a setting, it becomes equally apparent that arbitration agreements in payday loan transactions disproportionately harm borrowers. This harm leads to the conclusion that there is injustice in the use of arbitration agreements to settle such disputes.

The denial of justice through the use of arbitration agreements starts with the arbitration process itself. A consumer contemplating or defending a legal action against a payday lender through arbitration most likely cannot afford an attorney. They are, after all, payday loan customers. This leaves the consumer on her own to work through the arbitration process. While one of the benefits touted by supporters of arbitration is the relative simplicity of the process, this simplicity is understood from the perspective of lawyers, not payday loan customers. A review of the rules of arbitration from the three major arbitration service providers indicates a complexity that a layperson not trained in the law simply would not understand.

Additionally, empirical studies show that only a small percentage of people who sign form agreements read them, and an even smaller percentage actually understand them. This fact is complicated even further in the payday loan transaction by both the nature of the transaction and the population that comprises the payday loan industry’s customer base. The transaction itself is, by design, quick and easy, requiring little documentation to bind the customer. Also, the customer is often desperate for cash and will do or sign anything to get it. The circumstances of the transaction are simply not conducive to a full reading or understanding of the loan agreement. The lack of education that is common within the customer base of the payday lender adds to the confusion embodied in consumer loan agreements. The typical payday loan customer has a

168 See, e.g., Buckeye Check Cashing, Inc. v. Cardegna, 546 U.S. 440, 46 (2006) (upholding the validity of an arbitration agreement in a case where the payday lender, Buckeye Check Cashing, allegedly entered into an illegal, void ab initio, contract with its customers that violated the Florida Loan Shark Statute: “[B]ecause respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court”); ADD CITATION TO AGREEMENTS ON FILE WITH AUTHOR.


170 See Sternlight, supra note 140, at 1648.
below-average education and may not even speak English. It is therefore highly unlikely that this customer would read or understand an arbitration agreement included in a payday loan agreement.

A review of the payday loan agreements I obtained further supports this point. Of the three agreements, one contains a relatively simple, one-paragraph arbitration agreement, albeit with terms-of-art that only an attorney would fully comprehend. However, the other two agreements are stunningly complicated (and this assessment is being made by the author who is a law professor, expert in the field of consumer arbitration, and has drafted and reviewed numerous arbitration agreements over his career as an attorney). The first of these is written in sub-microscopic print on two pages and contains approximately two thousand words with nine numbered sections. The second agreement has nearly as many words over two pages, with thirteen lettered sections and an acknowledgment section. The terms contained in both are very technical and required several reads, references to Black’s Law Dictionary, and online research over the course of an entire afternoon to fully comprehend (by a contracts law professor). Given this, one can safely say that the typical payday customer does not read, nor fully understand the arbitration agreements they are forced to sign. 171

The complicated nature of an arbitration proceeding to a consumer, the complexity of the arbitration agreements themselves, the low relative value of a single consumer claim, and the fact that most payday lending customers do not or cannot understand the arbitration agreements contained within the terms of their loan, supports the assertion that payday loan companies rely on the in terrorem effect to dissuade consumers from bringing lawsuits. To be clear, it would indeed be a daunting obstacle for a payday loan customer with a valid legal claim to prevail in an arbitration proceeding. The gain to the payday loan company employing such an agreement is twofold: the company can use a relatively cheap and quick process to collect its debts and be assured that it will have significantly reduced the number of claims customers bring against it. By taking advantage of the technical nature of arbitration, the payday loan company is actually achieving a windfall that disproportionately and unjustly benefits the company at the expense of consumers.

The limit on discovery and class action waivers that are now common in arbitration agreements also disproportionately benefit payday lenders. Almost by definition, to prove predatory conduct you must prove a pattern. This would be particularly useful for a consumer bringing an action under a state’s Unfair and Deceptive Acts and Practices (UDAP) statute. The strict limits on discovery found in most arbitration providers’ rules and in many arbitration agreements virtually eliminate an aggrieved payday loan customer’s ability to prove a pattern of predatory conduct. Likewise, a class action waiver such as the ones contained in two of the three payday loan arbitration agreements obtained by the author provides a strong advantage to the payday lender.

171 Footnote about opt out in both and how it doesn’t really work. Appeals process for one, trap also.
The conceivable value of an individual payday loan customer’s claim against a payday lender is miniscule in the grand scheme of legal claims. Such claims are often limited to formulas related to actual interest paid and capped by certain statutes and regulations. Even if pursuing the claim under a more generous UDAP statute that provides for treble damages, the recovery is economically not worth individually pursuing in most cases.\footnote{See O’Donnell, supra note 161, at 13-16.} By stifling a customer’s ability to pool legitimate claims into a collective class, payday lenders are again impeding their customers’ ability to redress their grievances, further insulating the industry at the expense of its customer base.

The repeat-player phenomenon also counsels strongly against the use of arbitration agreements by the payday loan industry. There is significant evidence that arbitrators from at least one arbitration provider strongly favor business interests in consumer arbitrations.\footnote{Footnote about statutes, etc. also discussion about attorney’s fees and the fact that those are contractually removed in most arbitration agreements.} With regard to large volume areas, one cannot help but wonder if the additional monetary interests held by both the arbitration organization and the individual arbitrators lead to a conflict of interest in favor of the businesses seeking arbitration. An uneducated and economically disadvantaged payday loan customer, it appears, is facing a stacked deck when it comes to arbitrating against a company when both the arbitrator and the company are repeat players.

The strongest argument against allowing the arbitration of payday loan disputes is the public justice critique, which essentially argues that society benefits as a whole from the discussion of the law. Here, this critique is rooted in the loss of accountability and lack of transparency found in the arbitration process. When claims against payday lenders are taken private, society does not gain the benefit of learning about what these actors are doing and thereby loses, to a certain degree, its ability to determine the validity or invalidity of such conduct and whether to take collective action against it.

This is particularly troubling considering the predatory nature of the payday loan industry and its targeted customers. As discussed in section II supra, the acts and practices of the payday loan industry clearly demonstrate that it is a predatory industry that targets one of the economically most vulnerable populations in society for its customer base. Whether one looks at this population as a whole or its discreet segments, it is abundantly clear that these are people who cannot, alone, effectively protect themselves from the payday loan industry’s predatory practices. From a practical standpoint, the payday loan customer base does not have the educational or monetary resources to mount an effective defense, either individually or collectively. Additionally, through the use of arbitration agreements and class action waivers, the payday loan industry has further divided and marginalized this population and effectively hidden the problems that payday lending creates for its customers.
Broadly speaking, removing the obstacle of arbitration would enhance society’s ability, as a whole, to take appropriate action concerning payday loans. First, people with legitimate claims against payday lenders would be able to press those claims in the public setting of the courtroom, secure in the knowledge that there is some level of accountability and impartiality. Second, regulators would have more information available to them, providing a basis for appropriate remedial measures when necessary. Finally, placing the issue of payday lender conduct, or misconduct, in the open view of the public would increase public awareness and give the public a chance to support palliative legislative action.

C. Arbitration Agreements Further the Discriminatory Practices of the Payday Loan Industry

The payday lending industry’s deliberate and aggressive targeting of minority customers leads to disproportionate harm to racial minorities. In a previous article, I argued that consumer arbitration agreements might work if certain safeguards are met that would provide consumers with a real, educated choice, and also provide for a fair and accountable arbitration process. However, I believe that when used by predatory lenders, such as payday lenders, consumer arbitration agreements pose too great a societal risk to allow their use. This risk is exemplified by the injustice caused by mandatory arbitration agreements, which are disproportionately allocated to the industry’s minority customer base. From the in terrorem effect of arbitration agreements, to the bias produced by the repeat-player phenomenon, to the ability of the payday lender to protect itself from both valid consumer claims and regulatory knowledge, arbitration agreements are aiding payday lenders in furthering their discriminatory lending practices. Even if one attempted to organize a mass consumer arbitration scheme, which is ultimately unrealistic, the risks attendant to arbitrating consumer claims would be asymmetrically born by the payday lending minority customers.

For example, the disparate-impact theory is a discrimination theory that is particularly useful in correcting [“correcting” or “describing”?] wrongs perpetrated against minorities by lenders and lending institutions. Disparate impact occurs when a lender applies a neutral practice equally to all credit applicants, but the practice disproportionately burdens a group of persons on a prohibited basis.\footnote{Explain basic test.} The Equal Credit Opportunity Act (ECOA) applies to any extension of credit and prohibits discrimination based on, among other things, race or color and national origin. Disparate-impact discrimination is a viable claim, with both private and governmental causes of action under the ECOA. A payday loan is, likewise, subject to the ECOA’s prohibition against discrimination because it is an extension of credit. Although beyond the scope of this article, one could easily imagine an effective disparate-impact claim brought against a payday lender that is guilty of
disproportionately targeting minority neighborhoods. The growing number of empirical studies that look at the payday lending issue brings into sharp focus the fact that payday lenders are targeting minorities and that this has an excessive detrimental effect on minority neighborhoods and their residents. This predatory targeting and detrimental effect on its minority customer base demonstrates the disparate impact the payday lending industry has on people of color.

Unfortunately, for several reasons previously described, arbitration agreements effectively preclude the ability of aggrieved customers to institute a meaningful private suit against a payday lender that is savvy enough to use such an agreement. The inherent limitation of discovery in arbitration makes it virtually impossible for a plaintiff to gather the necessary proof to prevail in such a case against an individual payday lender. Additionally, the risks associated with the repeat-player phenomenon limits the likelihood that such a plaintiff would prevail and removes the public accountability that an arbiter should be subject to. The class action waivers found in many arbitration agreements also stunt a plaintiff’s ability to bring such a claim. Private disparate-impact claims are most effective when brought as a class, but such waivers are designed to prevent that possibility. Finally, government remedial action, while not hindered to the same degree as a private cause of action, becomes more difficult to achieve because information that would alert regulators is withheld from them by the private nature of arbitration.

Ultimately, it is the combination of the predatory actions of the payday lending industry and the deleterious effects of the arbitration agreements used by the industry that commands the conclusion that the risk posed by arbitration agreements in payday loan agreements is socially unacceptable. These agreements are currently used by an industry that is almost universally criticized for inhibiting its customer base’s ability to protect itself. Thus, arbitration agreements are recognized as a method by which payday lenders take undue advantage of people of color.

IV. Recommendations.

“Philanthropy is commendable, but it must not cause the philanthropist to overlook the circumstances of economic injustice which make philanthropy necessary.”

- Dr. Martin Luther King, Jr.

a. Payday loan industry not likely to go away.

This quote from Martin Luther King, Jr. rings true in so many areas of law. However, it is perhaps most accurate in its application to the circumstances surrounding the regulation of the payday loan industry. The payday loan industry is almost universally condemned, however efforts to curb the industry’s disastrous economic repercussions on its customers have largely
A major cause of this failure is the federal system in which our laws operate. Many states, for example, have instituted tough regulations of the payday loan industry. Unfortunately, these regulations often fail either because of the aggressive nature of the payday loan industry and the willingness of payday lenders to reach to new lows in order to sidestep regulatory efforts, or because of the lack of one universal standard applicable to the lenders activities.

A hard truth in the fringe banking world is the reality that products like payday loans are unlikely to go away. The amount of money at stake makes the practice of offering some sort of product that covers this niche market very attractive to lenders. Additionally, there is clearly some sort of demand for this type of product. However, the customers that are most likely to make use of this product are, generally speaking, the most vulnerable customers in the population. Further complicating this problem is the evident reality that these customers are ill-equipped from an education standpoint to fully comprehend the damaging nature of the loan transactions which they are entering. Lastly, with the exception of servicemembers, these customers do not have a political power base wherein they can effectively agitate for substantive change to benefit their position.

From the perspective of arbitration agreements, it is clear that such agreements cause excessive damage by way of increasing the risk of the denial of substantive courses of legal redress to consumers who are subject to arbitration agreements. This risk is significantly amplified when one looks at a predatory industry such as the payday loan industry that is clearly targeting minority customers. This targeting allows the payday loan industry to utilize arbitration agreements to further its discriminatory activity towards minority customers. The most straightforward recommendation in this respect is to ban the use of arbitration agreements in the payday loan transactions. This recommendation achieves two significant goals. First, it removes the potential cloak of arbitration, with the shadow of which many payday lenders are hiding their pernicious activities from public critique. Second, it re-opens the judicial system to the victims of payday lenders as a potential choice for the redress of grievances against payday lenders. While both goals are surely interrelated, one focuses on the public justice aspect of our judicial system, while the latter focuses on the individual justice aspect that system.

A model already exists for this solution, a model that goes beyond mere arbitration agreements and strikes at the predatory heart, so to speak, of the payday loan industry. The John Warner

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175 Reference articles summarizing failures.
176 Id., Supra cite.
177 Supra Cite
178 Supra note 175
179 Supra cite, minorities, women, servicemembers with limited education.
180 Supra cite
National Defense Authorization Act for the Fiscal Year 2007\textsuperscript{181}, in addition to banning arbitration agreements in consumer loan transactions for servicemembers, also bans many of the predatory acts of the payday loan industry. This law statutorily prohibits the charging of an annual percentage rate of interest greater than 36\%.\textsuperscript{182} While this is still a quite healthy interest rate, it is certainly an improvement over the existent interest rates which quickly reach the hundreds of percent in the average payday loan transaction. Additionally, the Defense Authorization act clearly requires the disclosure of loan terms to the consumer.\textsuperscript{183} The Act further imposes restrictions on a national level that target the very specific predatory nature of the payday loan industry:

\textbf{(e) Limitations.--}It shall be unlawful for any creditor to extend consumer credit to a covered member or a dependent of such a member with respect to which--

\begin{enumerate}
\item the creditor rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the borrower by the same creditor with the proceeds of other credit extended to the same covered member or a dependent;
\item the borrower is required to waive the borrower's right to legal recourse under any otherwise applicable provision of State or Federal law, including any provision of the Servicemembers Civil Relief Act;
\item the creditor requires the borrower to submit to arbitration or imposes onerous legal notice provisions in the case of a dispute;
\item the creditor demands unreasonable notice from the borrower as a condition for legal action;
\item the creditor uses a check or other method of access to a deposit, savings, or other financial account maintained by the borrower, or the title of a vehicle as security for the obligation;
\item the creditor requires as a condition for the extension of credit that the borrower establish an allotment to repay an obligation; or
\item the borrower is prohibited from prepaying the loan or is charged a penalty or fee for prepaying all or part of the loan.\textsuperscript{184}
\end{enumerate}

The prophylactic nature of section (e) is both impressive in its simplicity and comprehensive when analyzed in comparison with the payday loan activities that it targets. Recall the discussion in section II(B), supra, that detailed the predatory activities of the payday loan

\textsuperscript{182}See id, section (b).
\textsuperscript{183}Id. section (c).
\textsuperscript{184}Id.
industry. That section applied the activities of the payday loan industry to the predatory activities described in other academic literature. These activities included i. Disproportionate net harm to borrowers and greater than necessary fees; ii. Harmful rent seeking; iii. Fraud, deception, lack of transparency and misleading sales and marketing techniques; iv. Loan flipping or rollover; v. excessive prepayment penalties; and vi. The waiver of meaningful legal redress.

The Defense Authorization act addresses each of these activities clearly. The sharp limitation on the interest fees that can be charged servicemembers limits the first predatory activity, namely disproportionate net harm to borrowers coupled with excessive fees. Harmful rent seeking is also limited by this interest rate cap, as well as the prohibition against harmful loan continuation techniques and the establishment of agreed garnishment between the customer and the lender found in §§ (e)1 and 6 of the Act. The Act outright bans both rollover and the excessive prepayment penalty issues raised in predatory activity section, and further targets the deceptive marketing techniques and waiver of meaningful legal redress.\textsuperscript{185}

It is yet to be seen how effective the Defense Authorization Act will be in action as it is a relatively new regulatory effort, however the universal application of the standard set by the Act is a good and relatively easy way to start limiting the predatory activities of the payday loan industry. The Act, unfortunately, also illuminates a more sinister side of American polity, namely the preferential treatment of one class of citizens as opposed to ignoring other classes of citizens on a national level. The Defense Authorization Act clearly demonstrates that national legislators know about the problem posed by payday lenders. Congress and the Department of Defense understand the harm caused by payday lending transactions and know how to directly address these harms through legislation.

However, only a discreet segment of the national population is afforded protections against payday lenders. This segment of the population is clearly being afforded advantageous protections at the expense of other, less politically popular segments. The answer as to why from the powers that be is that payday lending affects military readiness. But it seems that perhaps there is more to the story than that. Servicemembers are highly valued constituencies to national legislators. One can almost imagine the “country, motherhood, and apple pie” mantra being invoked on the House floor as the Defense Authorization Act was being debated. Yet an enormous segment of our nation’s citizens – namely African Americans, Hispanic/Latino Americans, and Women – are ignored completely by the national legislature.

This lack of attention to historically disadvantaged peoples perhaps comes as no surprise to many in academia and the practice of civil rights law, it is yet another example of hierarchical preference towards valued constituencies over the traditionally discriminated against populations. Yet in this ever growing consumer credit-based economy, it comes as a stark

\textsuperscript{185} Id., §§ (e) 1, 2, 3, 5, 6, and 7.
reminder of the inequities faced by politically weaker groups in our nation’s political scheme. One harm – that against the valued constituency – is deemed unacceptable while the other harm – that against the weaker and less valued, although numerically superior, constituency – is deemed not worthy of action. Such a lack of action is intolerable in today’s consumer based economy and either denies economic rights to a large segment of the population, or economically privileges a small and darling segment of the population over the larger whole. And that, in a nutshell, encompasses what Martin Luther King, Jr. seems to be getting at in his quote at the beginning of this section.

V. Conclusion.

This article has clearly demonstrated the predatory nature of the payday lending industry. It has further illuminated the evidence that shows that the payday lending industry does in fact target, by and large, African American and Hispanic/Latino communities with what appears to be an additional negative effect on Women. Because of this disproportionate targeting, the arbitration agreements that are common in payday lending transactions disproportionately limit access to justice for these discreet groups. The article concluded, as so many law review article do, with a recommendation to expand and existing statute to protect the larger whole.

Yet this somehow does not ultimately answer the broader question. If successful and a statutory solution is enacted, will it be enforced? How can enactment or enforcement be ensured? What about root causes of the payday loan phenomenon – namely poverty and a lack of education? These are questions that likely cannot be properly answered by one – or even a series of law review articles from an army of academics.

What needs to ultimately happen is a revitalization of the American Progressive movement that goes beyond the identity politics that was the cause of the stalling of that very same movement. It is certainly important to focus on identity politics when necessary – the goals of feminists, African American or Hispanic/Latino race scholars are often quite separate. However, when an issue clearly crosses the boundaries of all such scholars and political activists, then there needs to be a readiness to address the issue as a collective whole.

The phenomenon of payday lending is such an issue. These lenders market their products to predominantly minority and women customers and given that reality scholars and activists with particular identity interest must combine forces in order to achieve just results for all of the affected constituencies, rather than simply focusing on one. It seems that this inability, or perhaps refusal, to join forces is a major factor that contributes to situations such as payday lending being regulated for the benefit of one popular group in our society while much larger and more disadvantaged groups continue to suffer from its scourge.