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Department of Justice

February 18, 1999

RE: Informal Advisory # 87
Deferred Deposit Loans, Chap. 533D
Debt Collection -- Threats of Criminal Prosecution

Dear

You have asked four questions about the relationship of criminal bad check laws to the deferred deposit lending business, commonly called "payday loans," or "check loans."

With your inquiry, you forwarded two collection letters used by payday lenders in conjunction with NSF checks which invoke the specter of criminal prosecution as a consequence of non-payment of a check loan. (Copies are appended as Attachment A, with the identity of the lenders redacted.)

SUMMARY

The questions arise as an outgrowth of a three year old statute which legalized the *business* of taking "cold" checks for deferred deposit in exchange for a fee, as a means of making small loans.

As will be discussed in detail below, these transactions are short-term, small-sum loans which are the subject of a special usury statute allowing extremely high interest rates. Because the check itself serves a dual function in these "check loans" or "payday loans" -- both as a substitute for the promissory note/credit contract/security agreement -- and, simultaneously, as a method of repaying the debt at a later time, *any* default on these loans will necessarily involve a bounced check.¹ It is

¹ Precisely because of potential complications as are presented by your questions, at least one state, when debating whether to legalize payday lending as an exception to its Industrial Loan Act, considered prohibiting the use of checks as "collateral" for these loans. Georgia failed to legalize payday lending as a business distinct from small loan lending,

this peculiarity of the "delayed deposit" lending business which demands special caution to assure that default on a small loan not be criminalized.

1. *Does the borrower's "bad check" in a payday loan represent a crime?*

While the Office of the ICCA Administrator is not vested with statutory authority to interpret Iowa Code § 714.1(6), the code provision making false drawing and uttering of a check (now referred to as "theft by check") a crime, it is necessary to examine how that provision would likely be applied to default on a payday loan to determine whether a payday lender's threats invoking the specter of criminal process violates the Iowa Debt Collection Practices Act, Iowa Code § 537.7103.

Given the way the payday loan, or "check loan" business operates, defaults on such loans will automatically involve a "bad check." Payday lenders have elected to go into the business of taking checks for which it is generally assumed that there are presently insufficient funds,² and they signify their understanding and willingness to accept such checks by charging a prepaid finance charge³ to do so. We believe that, under the Iowa Supreme Court interpretation of Iowa's bad check and false pretenses laws, the courts would consider this to be a civil, contractual matter. The Court has indicated that prosecutors should not be cast in the role of collectors, and civil litigants should not be encouraged to use the criminal system to obtain restitution for breach of contract. Defaulted check loans are quintessentially the type of transaction to which this analysis would seem to apply in all but the most extraordinary circumstances, and perhaps to entirely all defaulted check loans. (See Section III.)

so the proposed prohibition on the use of checks became moot.

² As is discussed below, the effective interest rates for check loans are very high. Those familiar with the business, including the lenders, assume that, were there sufficient funds upon which to draw when the checks are written, the borrowers would do so, rather than paying triple-digit interest rates.

³ A prepaid finance charge as used here means a finance charge that is considered earned at consummation, as distinguished from interest charged in reference to the time for which a loan is outstanding. Cf. Reg. Z, § 226.2(a)(23) (any finance charge paid separately in cash or by check before or at consummation of a transaction, *or withheld from the proceeds of the credit at any time.*) (emphasis added). As is discussed in Section I, below, the fee in a payday loan is withheld from the loan proceeds. See generally National Consumer Law Center *Truth in Lending* § 3.8 (3d Ed. 1995 & Supp.)

2. Can payday lenders seek criminal action against a borrower whose check bounces?

First, only county attorneys have the authority to file indictable criminal charges for theft by check.⁴ Even if default on a payday loan were to fall within the scope of the criminal code in any circumstance, at most a payday lender could ask a county attorney to evaluate the facts under the standards described below in Section III to determine whether there are sufficient grounds to warrant invoking public resources to pursue a default on a payday loan.

Second, it would appear that the legislature intended that the \$15 NSF penalty authorized in Chapter 533D be the exclusive penalty available for a defaulted payday loan. In that case, referral or threats of referral to public prosecutors for criminal prosecution would be prohibited, in all but the most extraordinary circumstances, if not entirely. (See Section IV.)

3. Does the criminal action represent a "legal action" that would require a notice of right to cure as required by the ICCC prior to the licensee taking such action?

As discussed above, the criminal system should be involved in a defaulted payday loan in only the most extraordinary circumstances, if ever. However, if a payday lender seeks to involve the criminal system, a notice of right to cure under the ICCC is required prior to its making such a referral. (See Section V.)

4. Even if the answers to the above questions are yes, would the practice of threatening criminal prosecution [or implying a threat of criminal prosecution] violate Iowa Code § 537.7103 if the licensee never does seek to press criminal charges?

In light of the answers to the earlier questions, we believe that threatening to invoke the criminal justice system to collect on payday loans is a violation of the Debt Collection Practices Act in any event.

However, any threat to invoke criminal sanctions to collect a debt is inherently coercive, and hence must be used with extreme caution to avoid abuse. Even if the courts were to determine that in some, extraordinary circumstances, prosecution in the context of a check loan default may be warranted, it would be impermissible under the Debt Collection Practices Act to threaten criminal

⁴ Checks under \$100 may be charged as simple misdemeanors, which may not be reviewed by the county attorney, as the "defendant" (debtors) may simply plead guilty at appearance. County attorneys are urged to discuss this potential problem with their law enforcement officers.

consequences in most default situations, and it would never be permissible to do so when the lender does not make such referrals. (See Section VI.)

As your questions demonstrate, a form of lending in which default can routinely be confused with criminality -- in the borrower's mind even if not in a prosecutor's mind -- requires special vigilance. It is worth noting that the industry itself recognizes that the use of checks as the note/collateral in these loans creates enormous potential for abuse because of the specter of criminal consequences. Industry representatives present at a recent meeting of credit regulators uniformly expressed the opinion that checks given in the payday loan context should not be the subject of criminal bad check laws.⁵

ANALYSIS

I. BACKGROUND: PAYDAY OR "CHECK LOAN" BUSINESS⁶

A. *Description of the Business*

In 1995, the Iowa legislature passed a new "special usury" statute⁷ which authorized those licensed under the statute to make short term, small loans at rates considerably in excess of the maximum allowable under the Consumer Loan Act,⁸ the Industrial Loan Act,⁹ or the general rate allowable for

⁵ Annual meeting of the National Association of Consumer Credit Administrators (NACCA), the association of state regulators under whose auspices payday lending occurs in states where it is permitted, or would occur if legalized. October 27, 1998 (San Diego, Ca.)

⁶ As the regulator responsible for licensing these lenders, the Division of Banking, of course, is intimately familiar with this background. However, advisory opinions are a matter of public record, and some people who may have occasion to refer to this advisory in the future, such as law enforcement personnel, may be unfamiliar with the operations of deferred deposit, or payday lenders.

Since it is necessary to understand the deferred deposit services business to understand this analysis, this response to your questions will begin with a description of the industry for the benefit of other potential readers.

⁷ "Special" usury statutes are those which permit lenders operating under their auspices to charge interest rates higher than the general usury statute, which in Iowa is found at Iowa Code Chap. 535. Special usury statutes typically involve licensing requirements, as does this one.

⁸ The Consumer Loan Act, Chap. 536, formerly the Small Loan Act, permits interest rates of 36% on loans up to \$1000, and a split rate of 18%-36% on balances up to \$25,000.

⁹ Iowa Code Chap. 536A. The maximum rate allowable under the Industrial Loan Act is 10% discount. Many finance companies carry dual consumer loan and industrial loan licenses under both Chapters 536 and 536A.

consumer loans under the Iowa Consumer Credit Code.¹⁰ The 1995 "Deferred Deposit Services Act" permits licensees to extend loans up to a maximum of \$500 and for periods of no more than one month,¹¹ and sets limits on fees and certain other practices.

Rather than take a promissory note or a contract and security agreement as evidence of the legal obligation to repay the debt, as is typically the case in a loan, a deferred deposit services licensee either takes a post-dated check, or takes a check dated the same day, but with the explicit understanding that the lender will not present the check for deposit until a later time.¹² Hence these delayed deposit loans are more commonly called "check loans" or "payday loans."¹³

The lender makes the decision to extend this credit immediately, generally without making a credit check. Instead, payday lenders generally ask for copies of recent pay stubs, bank statements, photo IDs, and/or recent utility bills.

¹⁰ Iowa Code § 537.2402 permits a maximum of 21% to lenders not authorized to charge a higher rate under other provisions of state or federal law.

¹¹ Chapter 533D sets forth the licensing requirements for "delayed deposit services" lenders. Iowa Code 533D.10(1)(b) and (c) limit the aggregate loan amount any licensee may extend to a borrower at any time to \$500, and the term to a maximum of 31 days.

¹² "Delayed deposit services business means a person who for a fee does either of the following:
a. Accepts a check dated subsequent to the date it was written.
b. Accepts a check dated on the date it was written and holds the check for a period of time prior to deposit or presentment pursuant to an agreement with, or any representation made to, the maker of the check, whether express or implied." Iowa Code § 533D.2(2).

In addition, there also may be an agreement signed. The Division of Banking has prepared a model combination agreement and disclosure statement which is furnished to those inquiring about Chapter 533D licenses as part of the license application package. A copy of the model agreement and disclosure is appended hereto as Attachment B. It is unknown how widespread the use of the Banking Division Form is. See note 27, below.

¹³ There are similarities in this modern payday loan to "salary lenders" or "wage-buyers" earlier in the century. One type of "salary lender," the "5-for-6 boys" would loan wage-earners \$5 on Monday, to be repaid with \$6 on Friday's payday, an effective annual percentage rate of 1040%. See Jackson Collins, "Evasion and Avoidance of Usury Laws," 8 Law & Contemporary Problems 55 (Winter 1941). See also F.B. Hubacheck, "The Development of Small Loan Laws," *Id.*, 108, at 120-121 ("wage-buyers"); George Gisler, "Organization of Public Opinion for Effective Measures Against Loan Sharks," *Id.* at 183-204.

It is interesting to note that such lending practices were considered a social problem at the time, and ultimately gave impetus to the development of the uniform small loan laws. See generally Symposium, "Combating the Loan Shark," 8 Law & Contemporary Prob. 1 - 205 (Winter 1941).

The borrower/maker writes the check in a face amount which includes both the amount to be borrowed (the cash advance) plus the fee. To borrow a \$100 cash advance, for example, the borrower would write a check for \$116.67.¹⁴ In exchange for the check, the borrower gets an immediate cash advance.¹⁵

At the time the loan is made, the lender/payee must disclose to the borrower/maker the anticipated date upon which the check will be presented.¹⁶ The check will either be post-dated to that date, or will be dated the same day, but the lender agrees not to present it until that later date. According to your office, two weeks is the most common term for a payday loan.

At the subsequent, agreed-upon date, the borrower/maker, theoretically, has two options under Iowa's payday loan law: a) he or she can redeem the check for a payment of the face amount of the check in cash or by money order, or b) permit the check to be deposited. As will be discussed later, renewal or refinancing of the loan, through payment of another fee, or writing another deferred deposit check to cover the old check plus a new fee, was not envisioned as an option under Chapter 533D, though enforcement to preclude such renewals is difficult.

In sum, when a deferred deposit licensee takes the check, not only does he understand clearly that there are not presently sufficient funds to cover the check, *but the lender/payee has chosen to make a business of taking such checks.* Moreover, the lender/payee imposes a charge on the borrower/maker to take the check for delayed presentment, and the charge imposed by the lender/payee is a dear one.

B. Limitations on Charges and Practices Under Chapter 533D.

Iowa law permits licensees to charge a flat fee of \$15 for the first \$100, and \$10 (pro rata) for each additional \$100 or portion thereof.¹⁷ For example, if a customer needs or desires \$100, to be repaid from his paycheck two weeks hence, he will write a check to the lender for the face amount of \$116.67. The lender/payee will immediately advance the borrower/maker \$100 in cash.

¹⁴ See I.B, below, for a discussion of the permissible fees.

¹⁵ In essence, the payday lender serves as an alternative to credit cards for small, short-term lending, but at significantly higher rates.

¹⁶ Iowa Code § 533D.9(2)(c).

¹⁷ Iowa Code § 533D.9(1). The fee operates similarly to discount interest, in that the fee compounds on itself.

The fee is a prepaid finance charge, and is unrelated to the time for which the loan is outstanding. The above fee schedule applies irrespective of whether the loan is for one day, or for the maximum 31 days.

Expressed as an effective annual percentage rate, the authorized fee schedule is extremely high, since the loan amounts are so small and the loan term so short. The lowest APR on a payday loan, using the flat fee authorized under Chap. 533D is 145.52%.¹⁸ (This would be the maximum loan amount, \$445, for the maximum 31 day term. The finance charge on that loan would be \$55, and the borrower would write a check for \$500 check, representing the total of payments). Most typically, the loans are for two weeks. A \$445 loan for two weeks would result in an effective APR of 322.23%; a \$100 loan for two weeks would result in an effective APR of 434.61%. Under the statutory scheme, a rate as high as over 6440% would be legal. A borrower who needs \$60 on Thursday, for example, to pay a utility bill, to be repaid on the following day, from his Friday paycheck would write a check for \$70.59, which would constitute an effective APR of 6442.25%.

Referring again to the sample \$100 borrower described above, at the end of the agreed upon two week period, he or she will either bring in \$116.67 in cash or money order and redeem the check, or the lender/payee will deposit the \$116.67 check.

One of the dilemmas facing policy makers in considering this type of lending is how to address the issue of renewals or "roll-overs." If the check would not clear if deposited, another fee could be paid to keep the check from bouncing. However, the cost of keeping a check from bouncing through repeated roll-overs can be extraordinary when compared to the amount actually borrowed. A borrower who defaults on a check loan is thus caught between the Scylla of paying high roll-over fees to keep the check afloat, and the Charybdis of a bounced check with its attendant consequences of higher fees and, so far as the borrower knows, potential criminal prosecution.

Two publicized examples illustrate the financial dilemma presented to a payday loan borrower unable to repay on schedule. Bank Rate Monitor Online describes a payday loan borrower in Kentucky who borrowed \$150 and paid over \$1000 over a six-month period without paying any of that \$150 principal. (She ultimately ended up in bankruptcy.)¹⁹ In Tennessee, one of the named

¹⁸ All rates referenced in this advisory are from the Iowa Division of Banking, "Delayed Deposit Services Business: Maximum Charges and Corresponding APRs," a chart provided to all licensees as part of the licensing application package. It is attached as Attachment C.

¹⁹ Rothman, Bank Rate Monitor Online 2/18/98, cited in Consumer Federation of America, *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry*, (Nov. 1998) (hereafter CFA Report). See note 74, below.

plaintiffs in a class action of payday loan borrowers borrowed a total of \$400, on which \$1364 was paid over 15 months, yet the debtor still owed \$248.²⁰

In enacting Chapter 533D, the Iowa legislature manifested an intent to try to prevent borrowers from incurring such excessive cost to avoid default and bounced checks, by making it illegal for a licensee to

repay, refinance, or otherwise consolidate a postdated check transaction with the proceeds of another postdated check transaction made by the same licensee.²¹

This was intended to prevent an indefinite cycle of repeated roll-overs and repeated fees. Moreover, Chapter 533D makes no specific provision for deferral fees, extension fees, or refinancing fees,²² and there is a specific prohibition on charging "any other charges or fees" apart from the ones listed.²³

However, as your office is aware, there are some practical problems in enforcing this legislative restriction. First, if the initial check was for less than \$250, the loan could, in effect, be renewed with a new fee by taking a second check. (Licensees are permitted to hold two checks from one maker at any one time.²⁴) Second, it is a difficult enforcement task to assure that a new check is truly a new transaction, instead of a renewal or refinance. Finally, a borrower may attempt to prevent a

²⁰ Goins v. Creditcorp, Circuit Court of Bradley County (Tn) Case No. V-96-175 (filed March 5, 1996) (amended complaint Para. 20), cited in CFA Report.

²¹ Iowa Code § 533D.10(1)(e).

²² Compare Iowa Code §§ 537.2503 and 537.2504, addressing the charges permissible for deferrals or refinancing under the ICCC generally.

²³ Iowa Code § 533D.10(1)(f).

²⁴ Iowa code § 533D.10(1)(a). The dollar limitation on that method of circumventing the roll-over restriction results from the prohibition against a licensee holding check(s) from one maker in the aggregate amount of more than \$500 at any one time. Iowa Code § 533D.10(1)(b).

Other states have reported problems with circumvention of such restrictions when the same people obtain licenses under different names. Again, the Iowa legislation makes an effort to prevent this problem by defining "licensee" to include a person related by common ownership, control, or financial interest. See Iowa Code § 533D.10(2).

check loan from bouncing one check loan, by going to a different payday lender, borrowing from Peter to pay Paul. The latter is not illegal under Chapter 533D, but it can have the same financial consequence for the borrower as if a single licensee were collecting all the renewal fees.²⁵

The potential for such an extraordinary drain of financial resources relative to the amount borrowed that can result from efforts to keep a check loan from defaulting ("bouncing"), and the intent of the Iowa legislation to limit that, are important to keep in mind in assessing the implications of permitting payday lenders to threaten criminal prosecution as a consequence of default on their loans.

II. OTHER APPLICABLE STATUTES AND PRINCIPLES OF CONSTRUCTION

Because these are simply short term, small loans, when they are made for personal, family and household purposes, other legislation governing consumer credit transactions apply along with Chapter 533D.²⁶ At the time the loan is made through the instrumentality of a check, Truth in Lending disclosures are to be given to consumers to inform them of the APR and finance charge.²⁷

²⁵ An early press story on check loans, in Missouri, reported this phenomenon of borrowers refinancing with other lenders when the first would threaten criminal prosecution. "Post-dated check firms may violate usury laws," *Kansas City Star*, p. 1-A, 10/23/88. (At the time, payday lending was not excluded from the small loan laws. The Missouri legislature subsequently enacted special payday loan legislation.) And a Wisconsin paper reported on a consumer who had borrowed \$1200 from the five payday lenders in town, and was paying \$200 every two weeks just on fees alone. Quoted in CFA Report, p. 6.

For this reason, one current proposal for legislative reform of payday lending would apply an outstanding dollar limit at any given time to an individual borrower/maker, not to a single licensee. Section 9, Model Deferred Deposit Loan Act (CFA/NCLC). Since many payday lenders already have the capability to monitor whether the prospective maker has a payday loan outstanding elsewhere, and do so, such a proposal is technologically feasible.

²⁶ In other states where the business of check-lending has (or had) not been specifically recognized by the state legislatures, check-lenders have tried to argue that they are simply "check-cashers," who cash checks for a fee, rather than lenders, and therefore should not be considered subject to special usury laws governing small loans. Inasmuch as efforts to evade usury laws have never been favored, and the law looks to substance, not form in interpreting usury laws and consumer protection laws, these efforts have not been successful. See, e.g. *Hamilton v. York, DBA HLT Check Exchange*, 987 F. Supp. 953 (E.D. Ky. 1997) (check loan is a loan subject to Kentucky usury statute); *Commonwealth v. Allstate Express Check Cashing, Inc.*, HD-44-1 (Cir. Ct. Richmond, Va. Oct. 20, 1993) (check loans were loans subject to Virginia Consumer Finance Act). Regulators in Alabama, Florida, Georgia, Kansas, Maryland, Michigan, Oregon, South Carolina and West Virginia have taken enforcement actions predicated upon the position that deferred deposit checks are loans. (CFA Report). See also Colo. Admin. Inter: #3.104-9201 (June 23, 1992)(payday and post-dated checks are consumer loans subject to Colorado UCCC).

²⁷ See, e.g. *Hamilton v. York, DBA HLT Check Exchange*, note 26, above. (check loans are consumer credit transactions subject to the requirements of the Truth in Lending Act, 15 U.S.C. § 1601, et seq.)

Additionally, they are consumer loans within the meaning of the Iowa Consumer Credit Code.²⁸ Hence, except where specifically displaced by Iowa Code § 533D, as is the case with the maximum fees, payday loans are also governed by the ICCC.²⁹

Special usury statutes which authorize high rates should be strictly construed to effectuate the purpose of protecting the borrower from excessive charges.³⁰ When a statute specifies maximum charges for credit, the allowable charges specified are typically held to fully define the allowable charges: no other charges are authorized, lest the setting of a maximum be a pointless exercise.³¹

In addition to the maximum fee and corresponding APR chart which licensees can use in making TIL disclosures, the Iowa Division of Banking has provided them with a model agreement and TIL disclosure form. (See Attachment B). Despite these efforts to make compliance easy for 533D licensees, failure to comply with TIL is among the most commonly cited examination failures. (See Attachment D; Division of Banking, "Delayed Deposit Services Business: Common Exceptions/Violations Found in Exams.")

²⁸ A "loan" is the creation of debt by the lender's payment of money to a debtor. Iowa Code § 537.1301(25)(a)(1). A "lender" is a person who makes a loan. Iowa Code § 537.1301(23). When the purpose of the loan is for personal, family or household use, and the lender is in the business of making loans, as Chapter 533D licensees are, these transactions meet all the definitional elements of a consumer loan in Iowa Code § 537.1301(14). See also authority cited in note 26, above.

²⁹ See Iowa Code § 537.1104, "This chapter being a general Act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can be reasonably avoided."

It should be noted that the ICCC, being a comprehensive consumer credit code, governs *all consumer credit transactions* made by any creditor, irrespective of whatever licensing statute that creditor operates under. Thus consumer loan licensees are bound by both Chapter 536 and 537; industrial loan licensees are bound by both Chapter 536A and 537; state-chartered banks, when they make consumer loans, are bound by both Chapter 524 and 537. Like its counterpart consumer lenders, 533D licensees are subject to both 533D and 537.

³⁰ See generally National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* § 9.3.1.1 (1995 & Supp.) [hereinafter *The Cost of Credit*]. Cf. Iowa Code § 537.1102.

³¹ See generally, *The Cost of Credit*, § 9.3.1.2. See also cases cited in *Id.*, § 8.5.3.2.1 note 308.

The Uniform Small Loan Act, for example, was designed to drive what were then freely called "loan sharks" out of business by creating a class of lenders permitted to charge up to 36 - 42% per annum. The law strictly limited the charges or fees other than interest that a lender could assess, and provided harsh penalties for lenders who took fees and charges in excess of that authorized. See F.B. Hubachek, *The Development of Regulatory Small Loan Laws*, 8 *Law & Contemporary Social Problems* 108, 117 (Winter, 1941). See also NCLC, *The Cost of Credit: Regulation & Legal Challenges* § 2.3.3.1.

This strict construction of permissible return on loans has ancient roots.

"This bond doth give thee here no jot of blood;

Chapter 533D, allowing triple digit effective rates for small loans, would fall into such a category. It enumerates two -- and only two -- types of authorized charges. The first is the \$15/\$100 and \$10/pro rata fee for the excess over \$100 authorized by § 533D.9(1). The second is a penalty "not to exceed \$15" which can be charged by the licensee if the check is not negotiable on the agreed upon date authorized by § 533D.9(2)(d). Like the restrictive language in the Uniform Small Loan Act,³² it is prohibited for a 533D licensee to "receive any other charges or fees in addition to the fees listed in subsections 533D.9(1) and (2)." Iowa Code § 533D.10(1)(f).

III. DOES THE BORROWER'S "BAD CHECK" IN A PAYDAY LOAN REPRESENT A CRIME?

Iowa Code § 714.1(6) defines theft to include the situation where a person

[m]akes, utters, draws, delivers, or gives any check, share draft, draft, or written order on any bank, credit union, person or corporation, and obtains property or service in exchange therefore, if the person knows that such check, share draft, draft or written order will not be paid when presented.

Whenever the drawee of such instrument has refused payment because of insufficient funds, and the maker has not paid the holder

The words expressly are 'a pound of flesh,'
Take then thy bond, take thou thy pound of flesh;
But in the cutting it if thou dost shed
One drop of [debtor's] blood, thy lands and goods
Are by the laws of Venice confiscate
Unto the State of Venice."

W. Shakespeare, *The Merchant of Venice* 4.1

It should be noted that at common law there was no right to collect interest on the loan of money at all, therefore, statutes permitting the charging of interest are to be construed strictly as to allowable return, as they are in derogation of common law. In a passage remarkably prescient to this situation, a neighboring high court states: "The origin of the right to collect interest is to be found entirely in statutory enactments, by which the right to collect interest 'was converted from a crime into a statutory privilege.' [citation omitted]. 'At common law, interest was allowed in no case...It is the creature of the statute alone, and to it we must look for authority for its allowance. If not authorized by the statute, it cannot be recovered.' [citation omitted]" *Schlesinger v. State*, 218 N.W. 440, 442 (Wisc. 1928). This passage has special relevance in this case, where we deal with a statute with a double layer of legislative conversion of what was formerly a crime into a statutory privilege: the first the charging of interest to which this passage refers, the second the commercialization of a trade in "cold" checks.

³² See note 31 above.

of the instrument the amount due thereon within ten days of the makers' receipt of notice from the holder that payment has been refused by the drawee, the court or jury may infer from such facts that the maker knew that the instrument would not be paid on presentation....

As the language of the statute indicates, the difference between an ordinary bounced check and the crime of writing a worthless ("cold") check is intent. For purposes of interpreting the criminal statute, the relevant time to look at the maker's intent is the time at which the check was written.³³

As a general rule, the very fact of post-dating a check "purged the transaction of its criminal character." Instead it implied that there were at the time of making the check no funds to pay, and the check instead "represents a promise to discharge a present obligation on a future date."³⁴

Absent fraudulent intent, the transaction becomes essentially one of extending credit to the drawer. If the payee of a postdated, worthless check indicates in some manner that his or her acceptance of the check constitutes an extension of credit to the maker, [footnote omitted] the transaction does not violate the bad check statute.³⁵

Over the past seven years, the Iowa Supreme Court's interpretation of criminal liability for post-dated checks has evolved. Because the change in the Court's interpretation has some relevance to interpreting an ambiguity in Chap. 533D that will be discussed in Section IV, below, a discussion of the time frame of that evolution is warranted.

³³ "... intent must be decided as of the date the check was delivered and the property received." *State v. Kulow*, 123 N.W.2d 872, 875 (Iowa 1963).

³⁴ 32 Am Jur 2d § 73, *False Pretenses*. See also Annotation, *Application of "Bad Check" Statute With Respect to Postdated Checks*, 52 ALR3d 464 (1973).

There is some authority that a check given in such circumstances may not be treated as a check at all. *Id.* §§ 2,5. The Iowa Supreme Court, however, rejected the notion that a post-dated check is not a negotiable instrument in *State v. McFadden*, 467 N.W.2d 578, 580 (Iowa 1991). While it is possible that the Court would distinguish that holding in a factual situation where, as here, the nature of the business venture is the taking of such checks, this advisory will not anticipate that event, nor rest on that theory.

³⁵ 32 Am Jur 2d § 73, *False Pretenses*. See also *State v. Doudna*, 284 N.W.113 (Ia. 1939)

Judicial Interpretation of 714.1(6) At The Time Chapter 533D Was Enacted:

In 1995, when Chap. 533D was enacted, the Iowa Supreme Court's position was this:

Our holdings establish that when there is an understanding between the parties that a check is not cashable at the time it is received, but will be made so at some time in the future, the representations made are only promises, there is no deception and thus, no criminal liability results under § 714.1(6). If, however, the surrounding circumstances *at the time a check is given*, including the statements made, are representations that sufficient funds exist *at that time* to cover the checks, then criminal liability may result even though a check is postdated. Our focus remains on the representations made at the time a check is delivered....

[If it is] established that both parties understood that a check was not cashable when delivered, [then] criminal liability is precluded as a matter of law.
(emphasis added)

State v. McFadden, 467 N.W.2d 578, 581 (Iowa 1991).³⁶

In the case of payday lenders, as has been noted, the licensees have expressly gone into the business of accepting checks for deferred deposit, knowing they are not currently payable, expressly for the purpose of extending credit. Moreover, it is an extension of credit to which the payee signifies assent by imposing a finance charge.³⁷ (It should be noted that an argument advanced to justify triple-digit interest rates is that there is risk involved in entering the business of taking "cold checks." If default on such loans implicates the possibility of criminal consequences, then the risk would be considerably lower than for any other kind of lending, and triple-digit effective annualized interest rates would then become far more difficult to justify.³⁸)

³⁶ See also *State v. Rojas-Cardona*, 503 N.W.2d 591 (Iowa 1993). *Rojas-Cardona* missed an opportunity to provide us with specific guidance from the court on the issue of post-dated check loans. The maker had written two post-dated checks. One represented a business loan of \$5000, with the post-dated check being for \$7000. Had this business "check-loan" complete with built-in finance charge, been the subject of the criminal proceeding, we might have direct precedent from the court on the question of criminal liability when a deferred deposit check is evidence of a consensual extension of credit. However, the borrower also wrote a separate post-dated check for \$3000, which was to have been payment for \$3000 of services rendered. It was the latter check which was the subject of the criminal prosecution.

³⁷ See note 3, above.

³⁸ There is, however, not yet empirical data available to support arguments one way or another as to whether the authorized pricing structure has a rational relation to risks and operational costs. Discovery in some private litigation in other states suggests overcompensation for the risk. And one payday lender's internet posting boasts of an average

At the time Chap. 533D was enacted, then, the Iowa legislature would have rightly understood that there was no possibility of criminal liability for default on check loans, under the Iowa Supreme Court's interpretation of Iowa's bad check laws.

Judicial Interpretations of the Criminal Liability for Post-Dated Checks Subsequent to 1995:

In 1996, the Iowa Supreme Court reversed *McFadden*. But in doing so, the court did not adopt the position that it now is a crime to bounce a check in the circumstances where the check clearly represents a promise to pay in the future. Rather, the current standard is:

"Under either [a charge of theft by deception³⁹ or theft by check,⁴⁰] a postdated check^[41] can be evidence of deception even though both parties knew the check was not good at the time the defendant issued it. In these circumstances, criminal liability should attach if at the time the defendant issued the check, the defendant (1) never had the intention to pay the check or (2) knew he or she would not be able to pay it. We now overrule our prior theft by check cases holding otherwise. Our solution is consistent with the interplay of theft by deception and theft by check laws found in §§ 223.3 and 224.5 of the Model Penal Code.⁴²

In reaching this point, the court, however, still takes the position that

the "failure to perform, standing alone, is not evidence that the actor did not intend to perform." Iowa Code § 702.9(5). The mere fact of nonpayment of a check is not sufficient. Something more must be shown to prove criminal intent....

Checks may be returned for a variety of reasons: not all of those reasons

30% per month return on their money. (Quoted in CFA Report, p. 3.)

³⁹ Iowa Code § 714.1(3)

⁴⁰ Iowa Code § 714.1(6).

⁴¹ The delayed deposit services act includes both post-dated checks and contemporaneously-dated checks taken for deferred payment by agreement in exchange for a fee. See note 12, above. We believe that the court would treat the two the same for these purposes, since the knowledge and intent to defer the deposit are the same for both types of checks.

⁴² *State v. Hogrefe*, 557 N.W.2d 871, 879 (Iowa 1996).

necessarily deserve criminal punishment. The court must make an inquiry as to all the surrounding facts to determine the intent with which the check (or promise) was made.⁴³

While § 714.1(6) provides the equivalent of a 10-day "cure" provision, failure to cure within that time is of little help in determining intent when applied to the check loan context. The failure to pay after notice does not create a presumption of intent, but rather is merely evidence from which a court or jury "could infer ... that the maker knew that the instrument would not be paid on presentation." Iowa Code § 714.1(6). This adds little to an exploration of intent, since there is no question that when a check is written in a deferred deposit loan, both parties are fully aware that there are insufficient funds in the account, otherwise there would be no point in incurring a triple-digit finance charge to obtain immediate cash.

Moving the date of relevant "intent" up from the date the check was written to the later agreed-upon date similarly does not add much light in these circumstances. Undoubtedly in only a vanishingly small percentage of circumstances would a court infer from the mere fact of failure to pay a standard loan after the expiration of the ICCC's right to cure that the borrower had a criminal intent to take by deception when he signed the note.⁴⁴

Invoking the 10-day cure provision of § 714.1(6) to create an inference of fraudulent intent is especially troubling, given the Catch-22 facing a payday loan borrower unable to make the check loan good on schedule. On the one hand, he is getting a collection letter which tells him that not making good on the check permits an inference of fraud and potential criminal consequences. On the other hand, the alternative of paying roll-over fees to avoid having the check bounce is how borrowers end up paying \$1000 for the privilege of borrowing \$400, a financial harm the Iowa legislature intended to preclude when it limited refinancing and renewal of these loans.⁴⁵ It seems unlikely in the extreme that the legislature thought, on the one hand, that consumers should be protected from incurring repeated renewal fees to keep a check loan from bouncing, but thought it nevertheless acceptable to instead permit the lender to threaten criminal prosecution where the debtor/maker was unable to make the check good.

⁴³ Id. at 878.

⁴⁴ Under the ICCC, debtors have 20 days to cure a default before a creditor can institute legal proceedings, including self-help repossession of collateral. Iowa Code §§ 537.5110, 537.5111. It would be ludicrous to suggest that the failure to cure within that time could create an inference that the borrower never intended to repay the loan, and knew he could not ever, thus justifying a charge for theft by deception. The failure to make a check-loan good after notice is the functional equivalent of the standard right to cure with respect to other forms of consumer credit transactions. (The difference is that the threat of criminal prosecution may haunt the defaulting payday loan borrower's mind.)

⁴⁵ See Sec. I.B, above.

Interplay of Iowa Code § 714.1 and Chap. 533D:

The Iowa court has not dealt with post-dated checks in the context of § 714.1(6) since the *Hogrefe* decision. However, it has had occasion to express its view that it is improper to use a charge of theft by deception to turn prosecutors into collection agents for contract disputes.⁴⁶

These facts, taken in a light most favorable to the prosecution, prove only that the appellant failed to perform a contractual obligation he had with the victim, and as such, his actions constitute, if anything, a breach of contract, which merits a civil remedy. An affirmance under the facts presented in this case would only serve to cast prosecutors in the role of judgment collectors and encourage potential civil litigants to seek a remedy in a criminal court in the form of restitution.

State v. Tovar, No. 118/96-2104, ____ N.W.2d ____, slip op 8-9 (July 1, 1998), quoting with approval *Smith v. State*, 665 So. 2d 1002 (Ala. Crim. App. 1995).

It is interesting to speculate whether the legislature would have sanctioned a small loan business in which default, by definition, would involve a bounced check, if it had known that soon, under a changed Supreme Court interpretation of our bad check law, prosecutors and courts might be put in the position of having to review every defaulted loan to determine whether prosecution was warranted.⁴⁷ Such speculation gains little, except to serve as a reminder that when a statutory enactment, in essence, converts what might have been a crime into a sanctioned act of commerce, it is necessary to be quite hesitant to recriminalize it in the absence of an expressed intent to do so in that statute.⁴⁸ This is particularly true given that, stripped of the complication of the check-form these loans take, at root what is at issue is default on a loan of less than \$500. That Iowa, like the rest of America, has long abandoned the notion that non-payment of a debt *per se* is a crime,⁴⁹ also militates against assuming that the Iowa legislature intended to recriminalize default in a credit transaction when it sanctioned the check-loan business.

⁴⁶ Theft by deception is Iowa Code § 714.1(3). Note that in *Hogrefe*, above, the Court articulated the same standard to evaluate post-dated checks under both § 714.1(3) and § 714.1(6), indicating that precedent under § 714.1(3) would be relevant to consider in looking at the applicability of § 714.1(6) to bounced checks in the check loan context.

⁴⁷ Given the growth of payday lending, the implication for the drain on resources for law enforcement is troubling. In two years, the number of payday loan licensees in Iowa increased from eight to 132 (as of December 1, 1998)..

⁴⁸ Cf. *Schlesinger v. State*, above, note 31.

⁴⁹ "No person shall be imprisoned for debt in any civil action, on mesne or final process, unless in case of fraud;..." Iowa Constitution, Art. 1, Sec. 19 (Const. 1846)

Taken together, the court interpretations of §§ 714.1(3) and 714.1(6) and the state of the law when the legislature authorized the commercialization of checks for deferred deposit (and priced such loans accordingly), strongly indicate that these transactions are quintessential models for application of the *Tovar* rule: they constitute contractual obligations in which prosecutors should not be cast in the role of collectors and lenders should collect as a civil matter, rather than seeking a remedy in criminal court in the form of restitution.⁵⁰

While interpretation of §714.1(6) is not within the statutory authority of the Administrator, we believe that the likelihood that the Iowa Supreme Court would treat defaulted deferred deposit check loans as criminal is so remote, or would occur in so few exceptional circumstances, as to make a payday lender's threats of criminal sanctions for nonpayment a violation of the Iowa Debt Collection Practices Act. (See also Section VI, below.)

IV. CAN A PAYDAY LENDER SEEK CRIMINAL ACTION AGAINST A BORROWER WHOSE CHECK LOAN BOUNCES? WHAT REMEDIES ARE AVAILABLE TO A PAYDAY LENDER?

As a threshold point, a lender does not have authority to institute criminal charges; only the county attorney or other authorized law enforcement officials may bring criminal charges.⁵¹ Consequently, even assuming nonpayment of a check loan could be considered a crime, the most a payday lender could do is bring the NSF check to the attention of law enforcement officials for evaluation as to whether charges are warranted. As is discussed in Section III, it appears unlikely in the extreme that nonpayment of a check loan would be treated as a crime.

The question as to whether payday lenders might nevertheless refer defaulted borrowers to law enforcement authorities raises the question as to whether Chap. 533D limits the remedies available to its licensees for non-payment of payday loans.

As an unsecured lender, a payday lender, of course, has all the civil collection remedies available to it that any other unsecured lender has when the consumer defaults. It can file a small claims action to collect the debt just as any credit card issuer, consumer loan licensee, or bank could do

⁵⁰ Precluding the application of bad check laws to defaulted check loans would not create great exposure to potential fraud for payday lenders. They may protect themselves simply by not extending a check loan to someone who has defaulted on a check loan in the past. Many payday lenders routinely use Telecheck or similar check reporting agencies, and thus are in a position to monitor both past check loan defaults, and even what other check loans are presently outstanding at other payday lenders.

⁵¹ Iowa Code § 331.756(1).

upon the borrower's default on an unsecured loan. If it obtains a judgment, it may garnish any non-exempt income or liquid assets to the same extent as any other judgment creditor in a consumer credit transaction.⁵²

Further, if the post-dated check or contemporaneously-dated check taken for delayed presentment is returned for insufficient funds, Chapter 533D specifically authorizes an NSF penalty. At the time these loans are made, the lender must disclose:

Any penalty, not to exceed fifteen dollars, which the licensee will charge if the check is not negotiable upon presentment on the date agreed upon. A penalty to be charged pursuant to this section shall only be charged by the licensee once on a check no matter how long the check remains unpaid. A penalty to be charged pursuant to this section is a licensee's exclusive remedy and if a licensee charges a penalty pursuant to this section no other penalties under this chapter or any other provision apply.

The last sentence in that section could be read as internally inconsistent. In the first clause, it says that the \$15 NSF fee is the exclusive remedy. That, of course, means that no other remedy for a defaulted check loan is permissible. But the second clause includes conditional language, "...and if a licensee charges a penalty pursuant to this section no other penalties under this chapter or any other provision apply." This might be argued to mean that if the licensee chooses not to invoke the \$15 NSF fee, then it might seek alternative remedies, for example turning to the criminal system, or invoking the NSF fee generally available under Article 3 of the UCC. (The latter is generally the greater of \$20 or 5% of the face value, with a \$50 charge allowable in certain circumstances.⁵³)

As was discussed in Section III, when the legislature enacted Chapter 533D, the state of the law interpreting §714.1(6) would have precluded criminal liability in the check loan context, so the legislature, which is presumed to know the law, would have assumed this to be a civil matter. Implicating the criminal system, therefore, would not appear to be an alternative to the \$15 NSF fee envisioned by the legislature.

⁵² If written for non-consumer purposes, the limitations on garnishment may be different. Compare Iowa Code § 537.5105 with Iowa Code § 642.21.

⁵³ Iowa Code § 554.3512. There is also a civil remedy for dishonor generally available under UCC Article 3, which authorizes treble damages under certain circumstances. See Iowa Code § 554.3513.

Viewing the Article 3 provisions as an alternative available at the lenders' discretion also is problematic. It makes little sense to limit a licensee to an "exclusive remedy" of \$15 in one breath, but then *sub silentio* add "unless, of course, you'd rather charge \$20 to \$50 or even treble damages, in which case, feel free." Despite the patent irrationality of such an interpretation, the provision, standing alone, is nonetheless ambiguous. When legislation is ambiguous, it is appropriate to refer to rules of statutory construction.

Read in conjunction with other relevant provisions, and in the light of applicable principles of statutory construction,⁵⁴ the indications are that the \$15 NSF fee provided for was intended to be the exclusive penalty available for default on a check loan, though inartfully drafted.

The first and foremost support for the interpretation that the \$15 fee was intended to be the exclusive remedy, as the first clause says, is found in the following provision of Chapter 533D. Section 533D.10 lists acts which are *prohibited* by licensees, among which is to "*receive any other charges or fees in addition to the fees listed in § 533D.9, subsections 1 and 2.*"⁵⁵ As described above, subsection 1 refers to the permissible finance charge,⁵⁶ and the **only** fee or charge listed in subsection 2 is the \$15 NSF fee. No other fees or charges are listed in the referenced §§ 533D.9(1) and (2). Consequently, the prohibited acts provisions of Chap. 533D.10 supports the reading that the \$15 fee is the **only** permissible fee relating to the non-negotiability of a check written in connection with a check loan.

A second point which supports the notion that the \$15 fee is the maximum, exclusive remedy is that, absent § 533D.9(2)(d), payday lenders might have been unable to obtain *any* NSF penalty fees at all, where the check was written for consumer, family or household purposes, as a result of otherwise applicable limitations in the ICCC.

ICCC and UCC provisions regarding NSF fees: As noted in Section II, above, payday loans for consumer purposes are subject to the ICCC except to the extent specifically displaced by the provisions of Chapter 533D, such as the maximum finance charge provisions. The ICCC prohibits the imposition of "any charges in connection with default" except in conjunction with

⁵⁴ See Section II, above.

⁵⁵ Iowa Code Sec. 533D.10(1)(f).

⁵⁶ See I.B, above

repossessions.⁵⁷ To reiterate, "default" on a check loan happens by virtue of having the check -- the dual-function note/contract/security agreement plus payment mechanism -- fail to clear.⁵⁸ Furthermore, the ICCC also enumerates an *exclusive* list of "additional charges" which are specifically authorized in consumer credit transactions.⁵⁹

It appears that the legislature intended that the ICCC prohibition against default charges under § 537.3402 and/or its exclusive listing of authorized additional charges under § 537.5102, apply to insulate consumer credit borrowers against punitive NSF check charges.⁶⁰

On May 1, 1995, the legislature enacted 95 Acts, ch. 137. Section 2 of that Act amended Article 3 of the Uniform Commercial Code (Chapter 554), the general law governing checks, to permit NSF surcharges of \$20 - \$50 in certain circumstances.⁶¹ Section 3 of 95 Acts, ch. 137 also amended Article 3 of the UCC, to authorize a stiff treble damages civil remedy for dishonor.⁶² However, Section 1 of 95 Acts, ch. 137 indicates that the legislature did not believe that Sections 2 and Sections 3 would apply as a general matter to ICCC transactions.⁶³ (In fact, Informal Advisories from this office interpreting the predecessor UCC law authorizing NSF charges had interpreted it

⁵⁷ Iowa Code § 537.3402: "Except for reasonable expenses incurred in realizing on a security interest, the agreement with respect to a consumer credit transaction other than a consumer lease may not provide for any charges as a result of default by the consumer other than those authorized by this chapter. A provision in violation of this section is unenforceable."

⁵⁸ "Default" under the ICCC is failure to make a payment within 10 days of the time required by the agreement, Iowa Code § 537.5109(1), or failure to observe any other covenant which materially impairs the consumer's prospect to pay amounts due. § 537.5109(2).

⁵⁹ Iowa Code § 537.2501.

⁶⁰ No part of the ICCC is to be deemed impliedly repealed by subsequent legislation if such construction can be reasonably avoided. Iowa Code § 537.1104.

⁶¹ Codified at Iowa Code § 554.3512. An NSF charge had been allowed under UCC § 554.3507(5) since 1984. That section was repealed as part of UCC Article 3 and 4 revisions in 1994, and the 1995 enactment of § 554.3512 reinstated and raised the allowable charge.

⁶² Codified at Iowa Code § 554.3513. The treble damages had been authorized under UCC § 554.3806 since 1985. It, too, was repealed as part of the 1994 revision of UCC Articles 3 and 4, and reenacted in 1995.

⁶³ Where there is a conflict between a specific statute, such as the ICCC which governs consumer credit transactions solely, and the UCC, which is the basic law governing commercial intercourse generally, the more specific controls.

not to apply to ICCC transactions.⁶⁴) Section 1 of 95 Acts, ch 137 separately amended the ICCC to make it parallel to Section 2's amendment to the UCC. Section 1 authorized a \$20 - \$50 surcharge, but continued to provide for NSF charges solely in transactions where the notice of the possibility of such a surcharge is clearly and conspicuously disclosed in "the cardholder agreement."⁶⁵ Thus the legislature acted to permit *credit card issuers* to impose an NSF surcharge in line with the UCC authorized surcharge in consumer credit transactions.⁶⁶

If the legislature had intended NSF surcharges authorized by Article 3 of the UCC to apply generally to all transactions including those subject to the ICCC, then § 537.2501(1)(g), (including the 1995 amendment thereto) would have been superfluous.⁶⁷ However, the inclusion of a more restrictive version of the NSF surcharges specifically applicable to a single defined category of ICCC lenders strongly indicates that the ICCC, as the more specific legislation governing consumer credit transactions, does not permit NSF fees as a general rule.⁶⁸

⁶³ See Inf. Adv. # 18 (Lowe, 8/27/84; the amendment to the UCC authorizing a \$10 NSF fee [former § 554.3507(5)] did not sanction NSF fees for ICCC transactions; amendment to ICCC would be necessary); Inf. Adv. # 43 (Lowe, 9/23/86; surcharges under § 554.3507 not available to ICCC creditors since § 537.2501 not amended, nor is there an administrative rule authorizing it under § 537.2501.)

⁶⁵ Codified at Iowa Code § 537.2501(1)(g), the section enumerating the authorized additional charges for consumer credit transactions. In 1989, that section had been amended to permit a \$10 over-the-limit fee and a \$10 NSF charge on credit-card transactions. 89 Acts, ch. 68, §§ 2 (OTL fees), 3 (NSF fees), codified as Iowa Code § 537.2501(1)(f) and (g). See note 68, below, as to why credit card accounts were likely given distinct consideration.

⁶⁶ "Cardholder" means a person to whom a credit card is issued. Iowa Code § 537.1301(7); a "credit card" is a "card or device issued under an arrangement pursuant to which a card-issuer gives a cardholder the privilege of purchasing or leasing property or services, obtaining loans or otherwise obtaining credit from the card issuer or other persons." Iowa Code § 537.1301(16). The use of the term "cardholder" as an adjective modifying "agreement" limits the universe of consumer credit agreements pursuant to which the surcharge is permissible.

⁶⁷ "A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous...." 2A Sutherland Statutory Construction Sec. 46.06 (5th Ed.)

⁶⁸ See also note 63, above. There being no legislative history, there is no official record as to why card issuers would have been singled out to be permitted the NSF surcharge. However, out-of-state national banks which issue the majority of credit cards from their home base in one of a very few deregulated states (such as Delaware and South Dakota), had started routinely imposing substantial NSF fees, along with late fees and over-the-limit (OTL) fees and higher interest rates in the mid-80s. The higher revenues so earned by the out-of-state issuers had been (and continue to be) frequently cited by state legislatures, including Iowa's, as a reason for amending their laws to permit their in-state card-issuers to charge higher fees "up to parity" with out-of-state banks. The initial authorization for OTL and NSF charges for credit cards was added to the ICCC in 1989, at a \$10 level, as this movement picked up speed.

In light of that background, it is perhaps significant that two months before the 1995 legislation passed in Iowa,

Consequently, absent the specific authorization of Chap. 533D.9(2), it would have been impermissible, by virtue of Iowa Code § 537.2501 and/or § 537.3402 for payday lenders to impose any NSF or other default charges on the consumer loan segment of its customer base.

Chap. 533D, with its own NSF provision, also was passed on May 1, 1995. Thus on the same day the legislature enacted three separate and distinct provisions regarding NSF fees, in three different contexts, each with a different set of rules.⁶⁹ Since statutes are to be harmonized where possible, it is improbable that the legislature intended that holders of NSF checks be permitted to "mix-and-match" at will. It is a rational legislative decision to authorize a smaller, \$15 surcharge for check loan lenders. First, as noted, they have made a decision to go into the business of accepting checks knowing there are insufficient funds when made (unlike other holders of NSF checks), and second, the authorized finance charge imposed on these check loans is at a very high rate, which is in part justified as compensation for the presumed extra risk involved in this type of lending business (also unlike other holders of NSF checks.)⁷⁰

Since chapter 537 is more specific than chapter 554, and chapter 533D is yet more specific than chapter 537, the logical interpretation under standard rules of statutory construction is that § 533D.9(2) articulates the "exclusive" remedy for bounced checks in the check loan context, § 537.2501(g) articulates the sole situation in which an NSF remedy is available in the remainder of the universe of ICCC-covered transactions, and that UCC Article 3 §§ 554.3512 and 554.3513 articulate the rules for the remainder of the larger universe of transactions.

the Office of the Comptroller of the Currency (the national bank regulator) had promulgated a proposed interpretation of the National Bank Act which signified its intent to interpret federal law to preempt state law limitations on a number of charges, including NSF fees. With such an interpretation in place, out of state credit card issuers could invoke the federal "exportation" authority to charge high NSF fees on their Iowa cardholders without regard whatsoever to any state limitations. See 60 Fed. Reg. 11924, 11940 (March 3, 1995). Around the country, local card-issuers asked their home state legislatures to raise or eliminate caps on credit card fees to permit them to "compete" with the out-of-state issuers' higher fees. In that context, the special treatment accorded card issuers by § 537.2501(1)(g), as amended in 1995, makes both economic and political sense. The "exportation" debate explains much of the special treatment afforded credit card issuers by state legislatures, seeking to prevent a threatened exodus of in-state issuers to the greener pastures of states which permit higher (or unlimited) rates, fees and charges.

The OCC's final rule, which included NSF fees within its preemptive scope, was subsequently published as 12 C.F.R. § 7.4001(a) (61 Fed. Reg. 4869, February 9, 1996), and upheld by the U.S. Supreme Court in *Smiley v. Citibank (South Dakota, N.A.)* 517 U.S. 735, 116 S.Ct. 1730, 135 L.Ed. 2d 25 (1996).

⁶⁸ The NSF bill amending the UCC and ICCC was 95 Acts, ch. 137; the Delayed Deposit Services Act was 95 Acts, ch. 139.

⁷⁰ See III, above.

V. DOES CRIMINAL ACTION REPRESENT A LEGAL ACTION THAT SHOULD BE PRECEDED BY A RIGHT TO CURE NOTICE?

You also asked whether criminal action is subject to the 20-day right to cure required for consumer credit transactions by ICCC §§ 537.5110 and 537.5111.

As discussed above, we do not believe that the bad check law is implicated by default on a check loan. However, assuming *arguendo* that it could be in limited circumstances, a notice of right to cure in accordance with Iowa Code §§ 537.5110 and 5111 would be required prior to a lender's referral to the county attorney.

A creditor is required to give a notice of right to cure "before commencing any legal action in any court on an obligation of the consumer and before repossessing collateral." Iowa Code § 537.5110(2).

A payday lender may not directly "commence" a criminal legal action; only the county attorney or law enforcement personnel may do that.⁷¹ Thus, assuming *arguendo* that default on a payday loan might implicate potential criminal liability under bad check laws, at most, the lender could contact the police or county attorney to provide them with information in an effort to encourage them to "commence" a legal action.

The ICCC is to be construed liberally to achieve its purposes, among which are to protect consumers against unfair practices by some collectors of consumer credit and to permit and encourage the development of fair and economically sound credit practices.⁷² The purpose of the right to cure is to give the consumer an opportunity to rehabilitate if possible, or to try to negotiate a work-out (where possible). Comment to UCCC 5-5110 (1974). Despite the fact that the lender cannot formally "commence" a criminal proceeding on his own, it is certainly inconsistent to require the opportunity for 20 days to cure prior to going to small claims court, but not to require it before attempting to set in motion the much more frightening and consequential wheels of the criminal justice system. Consequently, in the event it is determined that the criminal process may be implicated in connection with default on a payday loan in any circumstance, the lender must send a 20 day notice of right to cure under §§ 537.5110 and 537.5111 prior to taking action which could set in motion a criminal action.

⁷¹ See note 51, above.

⁷² Iowa Code § 537.1102.

VI. IN THE EVENT THERE ARE POTENTIAL CRIMINAL CONSEQUENCES ARISING FROM A BOUNCED PAYDAY LOAN CHECK, WOULD THREATENING OR IMPLYING A THREAT OF PROSECUTION NEVERTHELESS VIOLATE IOWA CODE § 537.7103 IF THE PAYDAY LENDER NEVER PRESSES CRIMINAL CHARGES?

Inasmuch as it is our interpretation of Chap. 533D and 537 that default on a check loan does not implicate the criminal process, threatening criminal consequences for non-payment of the loan would violate the Iowa Debt Collection Practices Act. Iowa Code § 537.7103.

However, in the event it is determined that it is theoretically possible to invoke the criminal process in connection with payday loans in some circumstances, it would nevertheless not be permissible for the lender to routinely make such threats.

The potential for abusive collection practices that post-dated or deferred deposit checks are well recognized. For example, the federal Fair Debt Collection Practices Act places strict limitations on the solicitation and cashing of post-dated checks. 15 USC § 1692f(2)-(4).⁷³

The threat of criminal consequences for non-payment of debt is inherently coercive and oppressive.⁷⁴ Using such threats is particularly problematic in the payday loan context, since it would put pressure on borrowers unable to repay a check loan to refinance a payday loan to keep the check from bouncing, a result the legislature sought to prevent.⁷⁵

Invoking the possibility of criminal consequences, then, must be done only when criminal consequences are

⁷³ The federal FDCPA does not apply to creditors collecting their own debts, so payday lenders are not subject to it.

⁷⁴ Cf. Iowa Code §§ 537.7103(1), (2).

Kentucky presents a case study in the problems created by the use of cold checks as evidence of a loan. While most magistrates and prosecutors in Kentucky held to the position that these were not subject to the bad check laws, a few warrants were issued, and a few unfortunate borrowers were in fact jailed. Some payday lenders had also taken the position that these loans were criminal matters, not subject to the automatic stay in bankruptcy, and sought to continue collection efforts despite the debtor's bankruptcy filing. (In fact, the bankruptcy trustee in Kentucky is the real party in interest in a class action filed against payday lenders alleging a variety of violations of laws. (Interview with Sidney White, Trustee, Nov. 19, 1998.)) The Kentucky legislature subsequently required payday lenders to post conspicuous notices saying that check loan customers will not be subject to prosecution or conviction for writing cold checks or for theft by deception. Ky. Rev. Stat. § 368.100(18), (as amended 98 Acts, ch. 601 § 9).

⁷⁵ See Sec. I.B, above, and note 25.

* legally possible, i.e., only if the courts determine that bad checks given in conjunction with a payday loan may be prosecutable under bad check or deception laws, rather than constituting contract disputes to be handled civilly;

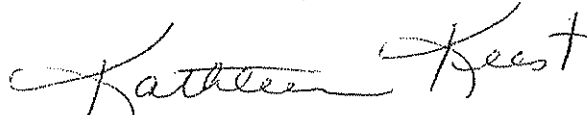
* intended to be sought, i.e., only if the lender has grounds to believe that a referral for criminal prosecution is appropriate (something more than mere default on the check loan) and intends to make the referral; and

* and are likely to be invoked,⁷⁶ e.g., if a county attorney rejected all of a payday lenders referrals, the fact that the lender intended to continue making futile referrals anyway would not make it a permissible practice.

* It would also be misleading and deceptive to suggest that a payday lender has the authority to file criminal charges, for only the county attorney may do so.

If you have further questions, please feel free to contact me.

Sincerely,



KATHLEEN E. KEEST
Assistant Attorney General
Deputy Administrator
Iowa Consumer Credit Code

/vsm

⁷⁶ Iowa Code § 537.7103(1),(2), (4). See also case law interpreting 15 USC § 1692e(2), (4), (5), (7), collected at National Consumer Law Center, *Fair Debt Collection Practices* Appx. H.2.4 (3rd Ed. 1996 and Supp.)