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Time and Money: One State's Regulation of Check-based Loans

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Abstract
This article, which is part narrative and part essay, describes one professor's experience working on “check cashing” (or “check-based loans”) cases at the Appalachian Research and Defense Fund in eastern Kentucky. Parts I and II describe the typical check-based loan transaction and its effects on low-income consumers. Part III recounts how the law of check-based loans has developed in Kentucky, during the professor’s time there and since. Part IV sets forth some observations about language and legal process, suggested by the preceding narrative.

Keywords
check based loans, check cashing, short-term loan, Truth in Lending Act, TILA, Racketeering Influenced and Corrupt Organizations, RICO

Disciplines
Banking and Finance | RICO
TIME AND MONEY: ONE STATE’S REGULATION OF CHECK-BASED LOANS

Deborah A. Schmedemann†

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I. INTRODUCTION

The call came at my home one evening in late July 1997: When would I be there? Would I like to work on the “check cashing” cases?

The caller was John Rosenberg, the much-honored director of the Appalachian Research and Defense Fund (Appalred), a legal services organization serving eastern Kentucky.1 Some months before, we had made arrangements for me to spend a sabbatical year as a volunteer staff attorney and “professor in residence” at Appalred’s office in Prestonsburg, Kentucky. I told him that I would be

† Professor of Law, William Mitchell College of Law. My thanks to the staff of the Appalachian Research and Defense Fund for permitting me to work with them for a year and to the administration of William Mitchell for affording me the opportunity to do so.

1. To learn more about Mr. Rosenberg and the organization to which he has dedicated nearly thirty years, see Milner S. Ball, The Work and the Law 16-24 (1993).
arriving within a week and that yes, I would be willing to work on “check cashing” cases. To pique my interest, John told me that evening how the transactions worked, but, I must confess, I understood little of what he said.

Over the course of the year that followed, I did indeed have the privilege of working on “check cashing” cases. I came to understand how the transactions work and how they affect the lives of consumers. Along with other Appalred attorneys, I worked on developing legal theories to challenge the practices of “check cashers,” and I watched and participated in the lawmaking process, in both the courts and the legislature. Since my return to teaching in mid-1998, I have watched the story continue.

What follows is part narrative and part essay. Although I initially adopted the term “check cashing” to describe such transactions, because it was common parlance, I have used the term “check-based loans” here, because it is more accurate. In Parts I and II, I have described the typical check-based loan transaction and its effects on low-income consumers. In Part III, I have recounted how the law of check-based loans has developed in Kentucky, during my time there and since. In Part IV, I have set forth some observations about language and legal process, suggested by the preceding narrative.

II. CHECK-BASED LOAN TRANSACTIONS

In December 1997, Judge Joseph M. Hood of the United States District Court for the Eastern District of Kentucky described the two stages of check-based loans as follows:

The following is how the “check cashing” transactions worked. The [borrowers] would give [the lender] a document in the form of a check in exchange for cash. [The lender] agreed to hold the “check” for two weeks before presenting it for payment or before requiring the [borrowers] to “pick up” the check by paying the face amount. [The lender’s] charge for cashing and holding the check for two weeks was 20% of the sums advanced.

2. I have chosen not to recount in much detail what occurred behind the scenes, in part because of concerns for confidentiality and in part because I clearly saw the lawyering on only one side of the case. Suffice it to say that there were moments of high intellectual discourse, mind-numbing factual investigation, mild panic, wry humor, serious frustration, complete befuddlement, exultation, and resignation.
The [borrowers] incurred the 20% charge for the use of [the lender's] money and the ability to delay the [presentment] of the check.

In the "deferral" transactions, upon the expiration of two weeks, [the lender] would allow the [borrowers] to defer presentment of their check in exchange for an additional 10% of the sum originally advanced for each week of deferral. The "deferral" fees were incurred by the [borrowers] in order to have more time to pay off their original "check." The [borrowers] allege that [the lender] knew or reasonably should have known that at the time of the "check cashing" and "deferral" transactions that they did not have sufficient funds in the bank to cover the checks given to [the lender]. If the [borrowers] had enough money in the bank to cover the amount they were asking for plus 20%, they would not have needed to borrow any money from [the lender].

For example, on July 1st, the borrower would write a check to the lender for $100 and date it July 15th; the borrower would receive $80 in cash. The borrower thereafter would have three options.

First, the borrower could do nothing, permitting the lender to present the check to the borrower's bank on or after July 15th. In the unlikely event that the borrower's account then had sufficient funds to cover the check, the check would clear, and the transaction would conclude. More likely, there would not be sufficient funds, and the check would return to the lender as NSF (not sufficient funds), i.e. a bad check. At that point, the lender would resort to some mechanism for prompting the borrower to make good on an NSF check, presumably criminal prosecution or the threat of criminal prosecution.

Second, the borrower could return to the lender on July 15th with $100 cash and buy back the check, thereby concluding the transaction. The borrower would have to have sufficient cash for this option.

Third, the borrower could return to the lender on July 15th and buy additional time by paying the lender, say, $20 to continue deferring presentment of the check to the bank for another two weeks. On July 29th, if the borrower could not buy back the check,

4. Id. at 958.
he or she could again extend the transaction for another fee, and so on. By late August, the borrower would have re-paid the $80 originally advanced—and still have to pay $100 to conclude the transaction.

Judge Hood contrasted check-based loans with standard check-cashing transactions:

[I]f a person walked into a check cashing establishment with a government check for $1,000 and the business gave him $900 for the check...the $100 payment would be a service fee, not discounted interest. The above $100 charge is considered a service fee because the business is not receiving the $100 for the use of its money, but rather the service of processing and providing instant cash to unbanked people.⁵

Note the essential differences between check-based loans and standard check cashing: Check cashing typically involves a check written by an employer or government welfare fund to the customer;⁶ check-based loans involve a check written by the borrower to the lender. Check cashers present the checks they receive for payment; in the typical check-based loan, the lender intends not to present the check to the borrower’s bank. Check cashing does not entail an ongoing obligation on the part of the customer; check-based loans do. Finally, the fees paid differ significantly: a single fee of, say, ten percent for standard check-cashing transactions versus an on-going fee at an annual rate of over 500%.

III. THE IMPACT OF CHECK-BASED LOANS ON BORROWERS

According to a March 1998 advertisement run by the Kentucky Deferred Deposit Association, a trade group of check-based lenders, 250,000 Kentucky consumers engaged in check-based loans.⁷ The specifics of their life circumstances no doubt varied somewhat, but most probably shared certain traits: low or moderate income, few financial resources, little sophistication in financial matters,

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⁵. Id. at 956. Judge Hood’s ten percent fee is much higher than standard; the Consumer Federation of America found in its 1997 survey that fees for cashing payroll and Social Security checks averaged 2.34% and 2.21% respectively. Jean Ann Fox et al., The High Cost of “Banking” at the Corner Check Casher: Check Cashing Outlet Fees and Payday Loans 4 (Consumer Federation of America 1997). The CFA report provides an overview of standard check-cashing practices and state laws.

⁶. Some check cashers also cash personal checks, typically for a hefty fee, averaging 9.36%. Fox, supra note 5, at 4.

and some pressing need for cash.

For example, Rebecca Reed, a hotel housekeeper and high school dropout, dealt with thirteen lenders, eventually seeking bankruptcy protection. She sought money to cover court costs and insurance fees after a car accident, for which she was uninsured because she had missed an insurance premium payment. Michael Hines, a student at the University of Kentucky and Wal-Mart employee, needed cash to pay off credit cards and cover his truck payment. He borrowed $350 and eventually paid about $3,000 in fees. Rodney Jackson, a retired police officer, borrowed $200 to get his car repaired, intending to repay the loan with the proceeds of a student loan and his Social Security payment. But he paid $500 in fees without discharging his obligation to repay the $200.

My experience was with individuals with such limited incomes that they qualified for legal services. They needed cash for everyday needs: car repairs, medicine, and children's clothes. They intended to buy back their checks with their next welfare or disability checks or paychecks. Until they were well into the cycle, most of my clients little understood the prices they were paying. Rarely had they read an explanation of the loan or been told how it worked—except that they understood full well that they would be prosecuted by the local county attorney for passing a bad check if they failed to pay the fees or buy back their checks.

By May of 1998, a lawyer representing the bankruptcy trustee for the United States Bankruptcy Court for the Eastern District of Kentucky reported that over ninety people had filed Chapter 13 petitions involving check-based loans. He stated, "They weren't buying food. They weren't paying utilities. They spent all of their Friday paying off check cashers."

11. Many were low-literate.
13. Id. at B2.
IV. KENTUCKY'S REGULATION OF CHECK-BASED LOANS

A. The Legal Landscape

In the late 1990's, Kentucky regulated small consumer loans from several angles. Consumer lenders were required to be licensed as such. They were prohibited from charging interest above 36% per annum. Lenders were required to provide certain disclosures of loan terms, including the annual percentage rate. They were forbidden from engaging in unfair, deceptive, false, misleading, or unconscionable practices.

Then, as now, federal law buttressed state regulation. The federal Racketeering Influenced and Corrupt Organizations (RICO) Act prohibits collecting an unlawful debt, which is defined as lending money at a rate twice that permitted by state or federal law. The federal Truth in Lending Act (TILA) requires disclosure of annual percentage rates, finance charges, and amount financed.

These statutes apply to loans and interest. The check-based loan industry maintained that the transactions were not, from a legal standpoint, loans, and the fees charged were not interest. Check-based lenders operated as check cashers under Kentucky's check cashing statute. The check cashing statute then read as follows: "Any fee charged by a licensee for cashing a check shall be disclosed in writing to the bearer of the check prior to cashing the check, and the fee shall be deemed a service fee and not interest."

The industry's position had a certain semantic appeal to it. In a check-based loan, the customer does receive cash, and the business does obtain a check. Especially if the ongoing nature of the obligation to pay a fee is overlooked, the business does seem to be charging a fee for a service.

15. Id. § 288.530. See also KY. REV. STAT. ANN. § 360.010 (Michie 1996) (general usury statute).
17. Id. § 367.110 (Michie 1996).
20. The terms vary from statute to statute. For example, TILA uses "credit" and "finance charge." 15 U.S.C. §§ 1602(e), 1605(a)(1994).
23. Id. § 368.100(2).
However, upon a close reading of the check cashing statute, one can see that check-based loans do not fit the statutory paradigm. For example, section 368.100(2), quoted above, refers to the customer as the "bearer of the check." The bearer of a check is "the person in possession of an instrument...payable to bearer."\(^{24}\) In a check-based loan, the customer, in writing a check to the lender, is the maker of the check, not the bearer. As another example, the check cashing statute provided that "[n]o licensee shall cash a check payable to a payee other than a natural person unless the licensee has previously obtained appropriate documentation from the board of directors or similar governing body of the payee clearly indicating the authority of the natural person or persons cashing the check...on behalf of the payee."\(^{25}\) This is nonsensical in the context of check-based loans, where the payee is indeed a business, i.e. the lender. That is, the check is payable to the lender ("other than a natural person"), so the lender ("licensee") must obtain documentation from its own board of directors ("the board...of the payee") indicating the authority of the customer ("the natural person") cashing the check on behalf of the lender ("the payee").

Furthermore, according to one of its sponsors, the purpose of the check cashing statute, as enacted in 1992, was to prevent check cashing businesses from charging excessive fees to cash payroll checks for military personnel without bank accounts and to prevent money laundering.\(^{26}\)

In contrast to the statutory language and its legislative history was the position of the Kentucky Department of Financial Institutions ("DFI"). The DFI licensed check-based lenders under the check cashing statute, a practice its acting general counsel endorsed in an affidavit filed in federal court.\(^{27}\) However, the DFI never promulgated regulations or engaged in case adjudication on the issue.\(^{28}\)

Without the shield of the check cashing statute, the transac-
tions clearly would amount to loans and the fees to interest. A standard definition of "loan" is "[d]elivery by one party to and receipt by another of a sum of money upon agreement, express or implied, to repay it with or without interest."\textsuperscript{29} "Interest" is defined as "compensation allowed by law or fixed by the parties for the use or forbearance or detention of money."\textsuperscript{30}

Furthermore, Kentucky law has long taken a substance-over-form approach to the matter of identifying a transaction as a loan, as in \textit{Hurt v. Crystal Ice & Cold Storage Co.}:

The cupidity of lenders, and the willingness of borrowers, to concede whatever may be demanded or to promise whatever may be exacted in order to obtain temporary relief from financial embarrassment, as would naturally be expected, have resulted in a great variety of devices to evade the usury laws; and to frustrate such evasions the courts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that \textit{the mere form is immaterial, but that it is the substance which must be considered}. No case is to be judged by what the parties appear to be or represent themselves to be doing, but by the transaction as disclosed by the whole evidence; and, if from that it is in substance a receiving or contracting for the receiving of usurious interest for a loan or forbearance of money the parties are subject to the statutory consequences, no matter what device they may have employed to conceal the true character of their dealings.\textsuperscript{31}

In addition, Kentucky case law has long distinguished fees for services from interest by focusing on their respective functions. A lender may, by good-faith agreement, charge fees for services, in addition to a legal rate of interest, so long as the fees are for services rendered, \textit{e.g.}, for a title examination or property appraisal, and "not a cloak to conceal usury."\textsuperscript{32}

In analyzing a check-based loan transaction, one might distinguish the initial fee (what Judge Hood called the "check cashing" transaction) from the fee paid later to continue the transaction

\textsuperscript{29} BLACK'S LAW DICTIONARY 844 (5th ed. 1979).
\textsuperscript{30} Id. at 729.
\textsuperscript{31} 286 S.W. 1055, 1056-57 (1926) (emphasis added).
\textsuperscript{32} Harding v. Ky. Title Trust Co., 108 S.W.2d 539, 548-49 (Ky. 1937), \textit{cert. denied}, 303 U.S. 635 (1938).
(what Judge Hood called the "deferral" transaction). The initial fee might be thought of as payment for the convenience of obtaining cash now, without the necessity of visiting a bank or bank cash machine; but the initial fee is rather large for such a convenience, and the real point of the initial transaction, in the era of ubiquitous cash machines, clearly is to buy the consumer time. The later fees can only be understood as buying time, that is, compensation paid to the lender by the borrower for detaining the lender's money for a specified period.

B. The Federal Court Litigation

In December of 1997, the United States District Court for the Eastern District of Kentucky ruled on the legal status of check-based loans under Kentucky and federal law. The case, Hamilton v. York d/b/a HLT Check Exchange, LLP, was brought by two borrowers who sought damages under various state and federal claims. The Hamiltons were represented by Appalred and a small firm from eastern Kentucky known for its success in trial work; HLT was represented by a large Lexington firm, Stites & Harbison. Hamilton was filed in Kentucky's Pike Circuit Court in August of 1997 and removed by the Defendant to federal court on the ground that the Complaint stated federal claims. After an extension of time to file an answer passed, the Defendant moved to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6).

Judge Joseph Hood's reason for denying the Defendant's motion to dismiss is most clearly reflected in this passage:

In looking at the substance of the transactions between the Hamiltons and HLT, as opposed to the form, the Court finds that the transactions were nothing more than interest bearing loans. HLT was not cashing the Hamiltons' checks, but rather, it was giving them short-term loans that could be deferred for an additional 10% per
In his ruling, Judge Hood relied on the Hurt case and dictionary definitions quoted above. He explained that the check cashing statute applied to cashing of government checks and not short-term loans, noting that otherwise, lenders "could make long-term loans as long as [they were] under the guise of cashing a check." He found no substantive authority for the Defendant's argument that the legislature intended to encompass short-term loans within the check cashing statute.

Accordingly, Judge Hood permitted the Plaintiffs’ claims based on Kentucky’s usury and consumer loan statutes and federal TILA and RICO to proceed. He further found that the Defendant had engaged in common law and statutory fraud by disguising the business as a check cashing operation, failing to disclose the terms of the loans, and threatening criminal prosecution for writing bad checks when the Defendant had to have known such a prosecution would not succeed based on a usurious loan.

While the scope of Judge Hood’s ruling is not stated in so many words, the opinion is written broadly enough to encompass both the initial and later fees. For example, he described the transactions not as cashing of checks, but as "short-term loans that could be deferred for an additional 10% per week."

The Hamilton case was not the first case to raise these issues in the Kentucky federal courts, although Judge Hood ruled first. In Miller v. HLT Check Exchange, the Plaintiff filed a bankruptcy petition in bankruptcy court for the Eastern District of Kentucky, and the Defendants (a company and its owner) filed a claim for a $600 NSF check written by the Plaintiff pursuant to a check-based loan...
The Plaintiff challenged the Defendants’ practices in an adversary proceeding, alleging violations of TILA and the Kentucky disclosure, usury, and consumer fraud statutes.\textsuperscript{47}

Ruling on the Defendants’ motion to dismiss,\textsuperscript{48} one week after Judge Hood ruled, Judge William Howard confined his analysis to what he called “renewal” charges, finding that the initial fee charged when the cash was received was not as “troubling” and “contemplated by” section 368.100.\textsuperscript{49} Refusing to dismiss the TILA claim, he found that the transaction fell within TILA’s scope:

\begin{quote}
[F]or the defendants to argue that they are not extending credit is disingenuous. They are disbursing funds to people like the plaintiff on the promise of repayment of the sum plus the “service charge,” at a later time. If this is not an extension of credit, this Court finds it hard to imagine any transaction that is.\textsuperscript{50}
\end{quote}

For the same reasons, Judge Howard refused to dismiss the claims under Kentucky’s disclosure and usury statutes.\textsuperscript{51} As to the consumer fraud claim, Judge Howard focused on whether the Defendants’ conduct in threatening a bad-check prosecution was unconscionable. Finding that such a charge could succeed or fail depending on the check-writer’s intent, Judge Howard ruled that the Defendants had not demonstrated that the Plaintiffs had failed to state a claim of unconscionable conduct.\textsuperscript{52}

In a footnote in his \textit{Hamilton} opinion, Judge Hood observed: “Surely, the Kentucky legislature did not intend for businesses to be able to ‘get around’ the usury statute and charge exorbitant interest rates by simply obtaining a ‘check cashing’ license. However, if this is what the legislature wanted, it will have to clarify its intentions.”\textsuperscript{53}

\textbf{C. The Legislative Response}

Whether clarifying its intentions or not, by April of 1998, the Kentucky General Assembly had responded. Chapter 601 states

\begin{itemize}
  \item \textsuperscript{46} \textit{Id.} at 972.
  \item \textsuperscript{47} \textit{Id.} at 971-72.
  \item \textsuperscript{48} \textit{Id.} at 972.
  \item \textsuperscript{49} \textit{Id.}
  \item \textsuperscript{50} \textit{Id.} at 974.
  \item \textsuperscript{51} \textit{Id.} at 974-75.
  \item \textsuperscript{52} \textit{Id.} at 975 (citing Rice v. Commonwealth, 821 S.W.2d 95 (Ky. Ct. App. 1991)).
  \item \textsuperscript{53} Hamilton v. York, 987 F. Supp. 953, 956 n.7 (E.D. Ky. 1997).
\end{itemize}
that the General Assembly was responding to an emergency: "the working people of the Commonwealth [are] being charged outrageous fees when they enter into deferred deposit transactions which has led many to economic ruin."\textsuperscript{54} Accordingly, chapter 601 was effective upon the governor's signature in mid-April.\textsuperscript{55}

One of the House bill’s sponsors stated that the new law's purpose is to regulate check-based loan businesses for the first time.\textsuperscript{56} Its strategy is to amend the check cashing statute. It added a new concept—deferred deposit transaction—and a new definition: "for consideration, accepting a check and holding the check for a period of time prior to deposit or presentment in accordance to an agreement with or any representation made to the maker of the check, whether express or implied."\textsuperscript{57} The new law requires a deferred deposit service business to be licensed.\textsuperscript{58} It adds various restrictions on deferred deposit transactions, including:

* a ceiling on service fees ($15 per $100 of the face amount of the deferred deposit check, for a fourteen-day period);\textsuperscript{59}

* a prohibition against altering the date on a check;

* a prohibition against unfair or deceptive acts;

* a restriction on the number and amount of transactions between a customer and a deferred deposit service business pending at any time (only one with a face value of over $500);

* a similar restriction on entering into a deferred deposit transaction with a customer who has outstanding deferred deposit transactions with another business;

* a limitation on the time period for holding a deferred deposit transaction (no more than sixty days);

\textsuperscript{54} 1998 Ky. Acts Ch. 601 § 15.


\textsuperscript{56} Statement of Rep. Jack Coleman, Reading and Vote on H.B. 226 before the Full House, Feb. 11, 1998, Legislative Research Commission Public Information Office Videotape \textit{(cited in White v. Check Holders, Inc., 996 S.W.2d 496, 499 (Ky. 1999)).}

\textsuperscript{57} Ch. 601 § 1 (amending Ky. Rev. Stat. Ann. § 368.010 (Michie 1992)).

\textsuperscript{58} \textit{Id.} § 2 (amending Ky. Rev. Stat. Ann. § 368.020 (Michie 1992)).

\textsuperscript{59} \textit{Id.} § 9 (amending Ky. Rev. Stat. Ann. § 368.100, the new language following the original language that renders the fee for cashing a check a fee for service rather than interest).
* a requirement of a written agreement;
* a ban on renewing, rolling over, or consolidating deferred deposit transactions for a fee;
* several provisions prohibiting the prosecution or threatened prosecution of a customer for writing a bad check, as well as requiring a sign stating the prohibition;60
* a provision permitting the collection of a fee for NSF checks, so long as the fee is disclosed to the customer;
* a provision stating that any personal check accepted from a customer must be payable to the licensee; and
* a requirement that the deferred deposit service business provide TILA disclosures and post a schedule of its fees.61

Chapter 601 was introduced January 9, 1998 and passed within three months.62 The industry, via the Kentucky Deferred Deposit Association, was actively involved; its chief lobbyist was former lieutenant governor Steve Beshear, and it spent over $100,000 on lobbying from September 1997 through April 1998.63 The interests of consumers were presented by the state’s attorney general, Kentuckians for the Commonwealth, the Consumer Federation of America, and Appalred.64 The bill underwent numerous amendments and triggered a conference committee, the main points of contention at the end being the permissible fee and the number of roll-overs permitted, if any.

The new statute may have fixed the rules for check-based loans entered into in April 1998 and thereafter, but a major question nonetheless remained.

60. Id.
61. Id. § 14 (adding a new section). The amendments also address licensure requirements, suspension of licenses, an administrative process available to aggrieved customers, and annual reports.
64. Correspondence and notes from the author’s file.
65. Susan Fernandez, Check-Cash Compromise Sets Rate at $15 per $100, LEXINGTON HERALD-LEADER, Apr. 1, 1998 at D1, D6; Robert T. Garrett, Check Cashers Avoid Lower Interest Limit, LOUISVILLE COURIER-JOURNAL, Apr. 1, 1998 at 01B. As those articles reflect, the final compromise was to permit a fee of $15 per $100 for a two-week loan and prohibit roll-overs entirely. Chapter 601 does so provide. It also contains a reference to an outer limit of sixty days for holding a deferred deposit transaction; that provision may be an inadvertent carry-over from an earlier version.
D. The Kentucky Supreme Court Decision

Litigation challenging check-based loans occurring before the April 1998 legislative changes continued. In one such suit, brought by the bankruptcy trustee for several debtors, White v. Check Holders, Inc., the United States District Court for the Eastern District of Kentucky certified to the Kentucky Supreme Court the question of the applicability of the original 1992 language of chapter 368 to check-based loans. 66 Deciding the certified question on June 17, 1999, the Kentucky Supreme Court ruled, "it is clear that the 1992 Act did not embrace deferred deposit transactions." 67

The court first observed that the plain language of the 1992 statute permits check cashing for a fee disclosed to the customer; there is no language permitting check cashers to advance funds and hold checks, thus providing short-term loans. 68 However, given the uncertainty generated by the use of a check to evidence the loan, the court turned to several sources for assistance: legislative history, administrative construction, case law, and subsequent legislative activity. 69

As to the legislative history of the 1992 statute, the court cited the purpose as stated above by Sen. Smith, 70 and the fact that the bill thereafter passed without amendment.

As to administrative construction, the court noted that the DFI did promulgate regulations regarding various features of check-based loan transactions, such as maximum fees, numbers of rollovers, or use of bad-check prosecutions. Although the Department "implicitly construed" the statute to cover check-based loans by licensing those businesses, that construction did not merit deference because it arose outside of rulemaking and adversarial proceedings. 71

As for case law, the court cited 72 the two federal court opinions in Hamilton v. York 73 and Miller v. HLT Check Exchange. 74

66. 996 S.W.2d 496, 496 (Ky. 1999).
67. Id. at 500.
68. Id. at 497.
69. Id. at 497-98.
70. Supra note 26 and accompanying text.
71. White, 996 S.W.2d. at 498.
72. Id. at 498-99.
Finally, the court turned to the 1998 amendments. According to the court, "[t]he 1998 amendments to KRS Chapter 368 demonstrate that the General Assembly intended, for the first time, to bring deferred deposit service businesses under the governance of KRS Chapter 368 and the regulatory authority of the DFI.\textsuperscript{75} The court gave several reasons for this conclusion. Rep. Jack Coleman, one of the bill's sponsors, had so stated.\textsuperscript{76} The amended statute refers to "cashing checks" and "accepting deferred deposit transactions"\textsuperscript{77} in the disjunctive, suggesting that these are two types of transactions, not the same transaction.\textsuperscript{78} If the 1992 statute encompassed deferred deposit transactions, there would have been no need for the 1998 amendments.\textsuperscript{79} The 1998 amendments add various provisions specific to deferred deposit transactions, such as caps on roll-overs and time limits.\textsuperscript{80}

Thus, the court ruled, section 368.100(2), as enacted in 1992, did not exempt deferred deposit transactions from usury and loan disclosure laws.\textsuperscript{81}

\textit{E. The Legislative Near Response}

Four months after the Kentucky Supreme Court ruling, its impact was being felt. Plaintiffs' lawyers filed several federal lawsuits, alleging fraud and racketeering and seeking class action status, against various check-based lenders.\textsuperscript{82} One lender filed for bankruptcy, claiming $200,000 in debts and $5,000 in assets.\textsuperscript{83} A University of Kentucky banking and finance professor opined that many check-based lenders would soon close shop.\textsuperscript{84} By mid-February 2000, there were at least ten federal lawsuits, three had been granted class action status, and the plaintiffs had obtained partial summary judgment in two of those.\textsuperscript{85} The lawyer for some of the

\begin{footnotes}
\end{footnotes}
plaintiffs stated that the industry could be facing damages of over $100 million.\textsuperscript{86}

Not surprisingly, the Kentucky General Assembly revisited the check cashing and deferred deposit statute in the 2000 session. House Bill 73 would have amended the statute in various ways, for example, adding definitions of “check cashing” and “postdated checks,” inserting the term “postdated check” in various places, requiring separate licenses for check cashing and deferred deposit businesses, tightening the Department of Financial Institution’s regulation of the latter, and adjusting the bases for calculating the fees for a deferred deposit transaction and the limits on outstanding transactions, setting bounds on charging of check collection fees, forbidding electronic debits of customers’ accounts, and explicitly limiting many provisions of the statute to licensees engaged in deferred deposit transactions.\textsuperscript{87} Most intriguing was the following provision, added by floor amendment in the House: \textsuperscript{88}

The General Assembly of the Commonwealth of Kentucky hereby declares that in enacting this Act, it is the intent of the General Assembly to do all of the following:

(1) To recognize that KRS Chapter 368 as created by 1992 Ky. Acts Chs. 213 and 341 (Senate Bill 311 and House Bill 747) in 1992 included deferred deposit transactions;

(2) To recognize further that in amending KRS Chapter 368 by the enactment of 1998 Ky. Acts Ch. 601 (House Bill 226) in the 1998 Regular Session, the General Assembly contemplated that deferred deposit transactions were check cashing transactions previously governed by the 1992 creation of KRS Chapter 368 and that it was not for the first time bringing deferred deposit service businesses under the governance of KRS Chapter 368 and the regulatory authority of the Department of Financial Institutions, but rather that authority to engage in deferred deposit service business and to have those transactions regulated by the Department of Financial Institutions had already been covered under the 1992 enactment of Chapter 368; and

(3) To clarify this issue of statutory interpretation, and to

\textsuperscript{86} Id.
\textsuperscript{88} H.B. 73, available at http://www.lrc.ky.us/record/00rs/HB73/bill.doc (adding new section to KY. REV. STAT. § 368.103 (1992)).
recognize, confirm, and declare that:

(a) Any check cashing company licensed under KRS Chapter 368, prior to the effective date of 1998 Ky. Acts. Ch. 601, that accepted and deferred deposit of personal checks was authorized to charge a service fee that specifically was not interest under KRS 368.100(2) and

(b) Therefore, charging of such a fee was not subject to the usury laws and disclosure provisions in KRS Chapter 360.\(^89\)

However, this statement of retroactive legislative intent was deleted by amendment in the Senate, and the bill as a whole did not pass.\(^90\)

V. OBSERVATIONS

It has now been several years since I first heard of “check cashing cases,” and I still find myself mulling over three related questions: What are the lessons to be learned about the role of semantics in business and law? How well did the legal process work, both as to resolving disputes and as to making law? And how much does the law govern behavior anyway?

A. About Language

Over the past several years, I have sought to describe check-based loans to various people: my family, students, faculty colleagues, lawyers, friends, etc. Brief descriptions seldom work. Most of the time, I have succeeded only by presenting one step at a time, first the initial exchange of a check for cash, then several rounds of continuing the transaction. Often I have identified myself as the lender and my partner in conversation as the borrower, and I have used specific figures (typically a $100 deal).\(^91\)

Despite the difficulty of the task, businesses and lawmakers have tried to capture what happens in simple names. Of course, each such name reflects a certain view.

I collected advertisements and forms during my year in Kentucky. The company names and product labels are interesting:

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89. Id.
91. Indeed, my most successful presentation (in my opinion) was a series of skits my husband and I performed over several months for my 1998-1999 Contracts class.
Speedy Cash offering "check advances," Cash 4 Checks calling upon customers to "get cash fast," Check Quest offering "cash in a flash," E-Z Cash, Check Exchange, Cash in Hand. Advertisements explaining the transaction typically stated that the business would cash the customer's personal check and hold it up to two weeks before depositing it. Not surprisingly, the advertisements emphasized only certain aspects of the transactions: cash now in exchange for a check, that is, the part of the transaction that would benefit and hence attract the customer. The typical form used to memorialize the transaction provided little additional information, describing the customer's financial obligation as payment of a "service fee," presumably a more palatable concept than "interest" or "finance charge."

As I worked with various borrowers, I came to appreciate, rather slowly, that for some borrowers, the written word mattered little. As low literates, they operated largely upon what they heard. And I inferred from what they said that they conceived of the transactions as the "cashing of checks."

I found it interesting that the industry's name for itself differed in tone and focus from the terminology used with customers. The industry's trade group name, the Kentucky Deferred Deposit Association, is a distinctly un-snazzy label focused not on the start of the transaction but rather (curiously) on the feature that differentiates the transactions from traditional check cashing. Furthermore, the label is somewhat imprecise, as what is deferred is not the deposit of the check (a bank's customer deposits a paycheck, for example, into her account), but rather its presentment.

So, the industry used various labels to depict the transactions in a favorable light for customers, on the one hand, and their trade group as an unremarkable and (presumably) responsible business entity, on the other hand. Ultimately, what came to matter most, in the late 1990's, was how the legal system conceived of the transactions.

As James Boyd White has observed, "[In] the law: we convert immediate experience into the subject of thought of a particular

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92. I was certified as an adult literacy tutor during my time in Kentucky, and I administered a literacy test to a number of clients, with their consent, of course.
94. One can only imagine how a legislator or regulator would respond to the Kentucky Cash-in-a-Flash Association.
kind, which has at its center the question of meaning: what this event means, and should mean, in the language of the law...95 Legal language matters greatly, of course, because legal consequences flow from labeling a transaction a certain way.

In the late 1990's, two legal categories existed into which one could fit the new check-based loan transaction. One group—the Kentucky Deferred Deposit Association, the lenders, their lawyers, and the Kentucky Department of Financial Institutions—saw the transactions as fitting into the largely unregulated legal category of "check cashing." A second group—consumer advocates, their lawyers, initially the federal courts, and then the Kentucky Supreme Court—saw the transactions as "loans" involving "interest" or "finance charges," that is, highly regulated transactions.

How could two such different opinions co-exist? Perhaps self-interest drove the analysis, at least for the parties to the transaction (and perhaps their lawyers). Probably the two groups focused on different points in time: the first group on the inception of the transaction, the second group on its probable continuation. The first group focused on the form of the transaction, the piece of paper we all deem a "check" and the currency we all deem "cash"; the second group focused on the substance of the transaction, the fee paid for the use of money over time.

I believe that the first group may also have succumbed to an impulse toward cognitive efficiency: the concept of "check cashing" existed in the Kentucky statute, it seemed to fit, and so it was applied. But such efficiency is not always appropriate. As the courts' opinions teach, in interpreting legislative language, one must also ask what the statute as a whole says and is about, what the legislators stated about their intentions, and what is good public policy.96 In understanding behavior that poses issues of legal categorization, one must look beyond the surface to discern what is really happening.97 In sum, the cases are testaments to the importance of substance over form.

One reason for resorting to cognitive efficiency may be the difficulty of developing a better label than the one that currently exists. The legal texts described above show the linguistic development of check-based loans. Judge Hood described the two phases

96. Supra notes 33-53, 66-81 and accompanying text.
97. Supra notes 38-41 and accompanying text.
as "check cashing" and "deferral" transactions—quotation marks included. When the legislature responded to the federal court decisions, it created the concept of "deferred deposit transaction." The Kentucky Supreme Court, responding to a certified question framed in terms of cashing checks and deferring deposits, not only wrote about "deferred deposit transactions" but also, simply, "short-term loans."

B. About Legal Process

The legal story told in Part III reveals much about the United States legal system, in both its dispute-resolving and its law-making roles. It also raises some interesting questions.

The story reveals various features of legislative law and process: the close connection between federal and state legislation, the processes of initial enactment and amendment, the reliance of the legislature upon administrative agencies, the responsiveness of the legislature to judicial action, the importance of participation by interested parties, the significance of legislators' statements of their intent, and (as noted above) the legislature's dependence upon words to capture concepts.

The story reveals various features of judicial law and process: the interaction between state and federal courts (in both the removal of a state court case to federal court and the certification of a question from the federal court to the state supreme court), the roles of specialized courts and courts of general jurisdiction, the various types of claims out of which a legal issue can arise (a simple claim, a responsive adversary proceeding in bankruptcy court, a class action), the importance of motion practice, the judiciary's role in interpreting statutes, and the judiciary's dependence upon words.

The story also reveals various features of administrative law and process: the classic roles of rules promulgation and case adjudication (not fulfilled here), the everyday roles of licensure and inspection, the agency's role in implementing statutory mandates, and the court's deference (or lack thereof) to the agency's expertise.

Furthermore, the story also shows how varied are the settings

98. Supra notes 3-5 and accompanying text.
99. Supra notes 54-65 and accompanying text.
100. White v. Check Holders, Inc., 996 S.W. 2d 496, 497 (Ky. 1999).
101. Id.
in which lawyers practice: rural legal services, a small rural firm, a large metropolitan firm, the attorney general, county attorneys, the bankruptcy trustee’s staff.

One broad question about this story as an example of the legal process is: How well has the legal system worked to resolve disputes between the check-based lenders and their borrowers? One can ponder both the fairness of the outcome and the fairness of the legal proceedings.

So far as I am aware, there is no case reporting a borrower’s recovery against a lender based on loans predating the 1998 amendments. Borrowers can seek a wide range of remedies, including return of sums paid, forgiveness of unpaid interest, double and triple damages, actual damages, and conceivably punitive damages. As noted above, some observers deem the potential liability large enough to force some lenders to close. Whether large recoveries and business closings are good results is open to debate. Not surprisingly, my own view is that check-based lenders operating, before the 1998 amendments, as though they were unregulated check cashers did indeed engage in exploitative practices, and significant sanctions are warranted, including damage awards sufficiently large not only to compensate borrowers but also deter wrongdoing.

As for the fairness of the legal proceedings, I find the story told above both heartening and disheartening. It is heartening that both sides found able advocates, that the mechanisms for resolving the significant legal issue existed, and that the courts responded fairly promptly to decide that issue. It is disheartening that a fast and simple process for resolving the many individual cases, now factual disputes arising under fixed legal rules, is not readily available. One hopes that the lawyers in the class action litigation will devise such a system, so as to avoid protracted legal proceedings that deny borrowers much needed compensation and suspend lenders in financial limbo.

A second broad question about the story as an example of the


103. I am less condemning of businesses operating under the strictures and spirit of the 1998 amendments; indeed, they may provide a useful means of providing cash for crisis situations to people with limited options.

104. My perception of the relative speed of the process does not necessarily reflect the views of my clients however. It was hard to explain, for example, why the Defendant in the Hamilton case did not tender a real response until two months after the Complaint was served.
legal process is: How well has the legal system worked to make law? One can debate what the law should permit and prohibit. Not surprisingly, my own view is that significant regulation of check-based loans is warranted to assure that the cost, amount, and duration are limited and that the borrower is thoroughly informed.\(^{105}\)

I find the story a fascinating example of how a rule of law is articulated, over time and through various mechanisms. The media covered this story frequently, providing some insight into how the law was understood. In an article in the *Lexington Herald-Leader* in October 1999, the author recounted past events, ending with the ruling of the Kentucky Supreme Court, and stated, “[C]heck cashers suddenly were vulnerable for their past conduct.\(^{106}\)

To my mind, the lenders had always been vulnerable; the law had always been that check-based loans were regulated as small consumer loans, subject to usury, disclosure, and anti-fraud laws. When the federal judges ruled in *Hamilton* and *Miller*, they confirmed, with considerable authority, what was already so. The 1998 amendments changed the rules as to future transactions, but they did not, of course, alter what had been the law before that point; indeed the amendments, in explicitly addressing check-based loans, implicitly confirmed that check-based loans were not previously covered by the check cashing statute. The Kentucky Supreme Court ruling in June 1999 further confirmed, as authoritatively as possible, what the law was before 1998.

Nonetheless, in others’ minds, the rule of law was not so clearly articulated. Why? In part, as discussed above, semantic difficulties gave rise to some confusion. In part, the confusion stemmed (I think, based on my conversations with lenders and lawyers for lenders) from lack of clarity as to who or what articulates the law. The industry apparently relied on the murky position of the Department of Financial Institutions. Some discounted the federal court rulings as insignificant, pending a decision by the Kentucky Supreme Court. Some deemed the 1998 amendments irrelevant to the issue of previous law. The media compounded the

\(^{105}\) One of the harder moments for me during my time in Kentucky came as I interviewed an individual who engaged in check-based loan transactions occurring after the effective date of the 1998 amendments. Mindful of the critical role that threats of prosecution played in earlier transactions and aware that the new law requires written notice that lenders cannot prosecute clients for bad checks, I asked the client whether she had been given written notice. Then I learned that she did not know, whether she had or not, due to her low literacy.

\(^{106}\) Cheves, *supra* note 81, at B1, B2.
confusion by routinely stating that the industry was not regulated until the 1998 amendments; presumably the media missed the point that a transaction may be regulated not only by a specific statute, but also by broad statutes and general legal principles.

One would reasonably assume that the Kentucky Supreme Court decision would settle the matter, especially given its thorough discussion of the original statute and its amendment, the administrative position, and the federal cases. The proposed 2000 amendment discussing legislative intent, quoted above, appears as a rather startling attempt to undermine whatever authoritativeness the legal system finally obtained as to the rule of law for pre-1998 check-based loans. Happily, it was not enacted.

C. About Law And Behavior

During my time in Kentucky, I was acutely aware of being involved in twin processes, dispute resolving and law making. I came to realize that they are fraternal, not identical, twins. That is, rules of law do not alone govern the resolution of disputes, at least in the informal process of negotiation. I expected that other factors, such as attitudes towards risk, tolerance of conflict, and financial circumstances, would matter; indeed these factors did, often times inclining borrowers in pre-1998 transactions to accept less than their full legal entitlement.

What I had not anticipated, at least not much, was that both sides to these transactions would rely so substantially on non-legal norms. My borrower clients, when told of the law affording them various remedies, reacted various ways. Some, fueled mostly by legal norms, did indeed perceive that they had been exploited and wanted to secure the full range of legal remedies available to them. But others, influenced mostly by the exigencies of daily life, simply wanted to walk away with no further obligation to—and an assurance of no further pressure from—the lenders. Others, looking beyond the law to personal standards of conduct, felt obligated to make reasonable efforts to pay back the cash advanced, even if the fees already paid equaled the cash advanced. Even when told of the law forbidding their conduct, lenders would routinely defend it on two grounds: that the borrower had made a choice and a contract, unencumbered by whatever the law might say.
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