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If There Is No Rate, You Must Rebate: Small Loan Laws in Oklahoma

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IF THERE IS NO RATE, YOU MUST REBATE: SMALL LOAN LAWS IN OKLAHOMA

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I. INTRODUCTION

Driving down old Route 66 in Tulsa, Oklahoma one is likely to see several businesses offering “Cash Loans!” or “Fast Cash - Approved Immediately!” This is not false advertising. A \$660.00¹ loan can be obtained from such small loan companies in less than an hour. However, the simplicity of obtaining this type of loan is deceptive. While the borrower may be relieved upon receiving such fast cash, it

1. See OKLA. ADMIN. CODE tit. 160, § 20-18 (1997).

is doubtful she realizes the actual cost of her loan. Although there is no specific rate of interest set by the Oklahoma statute governing such loans, acquisition and handling charges permissible on small loans allow for calculation of an annual percentage rate ("APR") that often equals over 100% on the original loan, and possibly over 300% in the event of refinancing.²

The small loan industry caters to an estimated one-third of America's adult population who typically have no access to traditional sources of credit.³ Alternative financial services, such as the small loan industry, provide non-depository access to credit.⁴ Typically, the industry extends credit at high rates to low-income, high-risk borrowers who cannot afford, or do not qualify for credit from depository institutions or banks.⁵ Specifically, small loan lenders provide access to fast cash loans at rates three times as high as traditional banks.⁶

The small loan industry in Oklahoma is governed by § 3-508B of the Oklahoma Consumer Credit Code ("OCCC").⁷ Loans made under this provision are typically referred to as "B" loans. Such "B" loans authorize account-specific charges⁸ in lieu of finance charges or rate ceilings applicable in other loan statutes⁹ and thereby do not set a specific rate of interest for this type of loan. Although § 3-508B charges may be converted to an APR to satisfy Federal Truth in Lending Law ("TILA") disclosures,¹⁰ there is no maximum rate of interest fixed as required by the Oklahoma Constitution.¹¹ The statutory discrepancy makes the "B" loan provision constitutionally suspect because the Oklahoma Constitution authorizes the legislature to set a *maximum rate of interest* for loans, not a *maximum charge* on loans.¹² That the charges can be converted to an APR to satisfy TILA requirements simply does not fulfill the constitutional mandate. In addition to the absence of a maximum rate of interest, the fees authorized by the provision may also be suspect. When the Oklahoma courts rule on the constitutionality of § 3-508B, they may also be forced to decide whether the fees authorized by the statute constitute interest calculable for

2. See Joe Robertson, *Consumers Needing Quick Cash Easy Target*, TULSA WORLD, Jan. 13, 1997, at A1 [hereinafter Robertson, *Consumers*]. See also *infra* Part IV.

3. See Heather Timmons, *Finance Firm's Clients No Easy Pickings for Bank*, AMERICAN BANKER, Nov. 4, 1996, available in 1996 WL 14013213.

4. See JOHN P. CASKEY, FILENE RESEARCH INSTITUTE CENTER FOR CREDIT UNION RESEARCH, LOWER INCOME AMERICANS, HIGHER COST FINANCIAL SERVICES I (1997) (defining alternative financial services generally as non-depository suppliers of credit such as check-cashing outlets, small loan companies, pawnshops, and rent-to-own companies).

5. See *id.* at 27.

6. Compare Robertson, *Consumers*, *supra* note 2, at A1, and OKLA. STAT. ANN. tit. 14A, § 3-508A(2)(a) (West 1996) (stating depository institutions making loans for \$660 or less are limited to charging a maximum 30% interest rate).

7. See OKLA. STAT. ANN. tit. 14A, §§ 3-501 to 3-515 (West 1996 & Supp. 1999).

8. See *id.* § 3-508B(1).

9. See, e.g., OKLA. STAT. ANN. tit. 14A, §§ 3-201, 3-508A, 3-605 (West 1996) (setting a maximum rate of interest for each type of loan).

10. See 12 C.F.R. § 226 (1996).

11. See OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

12. See *id.*

usury purposes.¹³

This comment discusses the small loan laws in Oklahoma with specific focus on § 3-508B of the Oklahoma Consumer Credit Code. After overviewing the small loan market and its borrowers, the comment outlines the genus and statutory construction of the “B” loan provision including recent amendments to the provision. The author argues rates authorized by § 3-508B are unjustifiable either on a risk or competitive theory basis and more importantly, from a public policy standpoint. Further, small loans could be governed more equitably by § 3-508A. Next, a strict interpretation of Article XIV § 2 of the Oklahoma Constitution renders the “B” loan provision unconstitutional because § 3-508B does not provide for a maximum rate of interest, and thereby authorizes usurious rates prohibited by the state constitution. Finally, should the courts fail to find the relevant statute unconstitutional, the legislature must consider further reforms to § 3-508B.

II. THE SMALL LOAN INDUSTRY AND ITS LOW-INCOME CUSTOMERS

Logically, there is a high correlation between low-income borrowers and borrowers qualifying as high credit risks. A study of small loan borrowers in Oklahoma reveals that over 70% of high credit risk borrowers earn under \$20,000 per year and have less than twelfth grade education.¹⁴ The poor¹⁵ and less educated are representative of the population seeking the type of small loans governed by § 3-508B.¹⁶ High-risk borrowers are not only those with negative credit history or a poor credit rating, but also those with no savings, little collateral, or unstable employment histories.¹⁷ Accordingly, these are all typical characteristics of the low-income population as well. The economic and social status of the low-income portion of the population render it more vulnerable to the predatory lending measures engaged in by small loan lenders and authorized by the “B” loan provision.

Due to the increasing lower income population and public administration deregulation, the small loan industry has considerably expanded both in profit margin

13. See Plaintiffs' Combined Response Brief in Opposition To All Defendant's Motions for Summary Judgement at 19-20, *Turner v. World Acceptance Corp.*, (Okla. 14th Dist. Ct. filed Aug. 3, 1998) (No. CJ-97-1921) (alleging OKLA. STAT. ANN. tit.14A, § 3-508B violates Article XIV § 2 of the Oklahoma Constitution (amended 1968)) [hereinafter Plaintiff's Combined Response, Aug. 3, 1998]; see also Joe Robertson, *Small-Loan Industry Sued By Consumers*, TULSA WORLD, Apr. 19, 1997, at A1; *infra* Part IV.

14. See Willis J. Wheat, *A Study On the Status of the Class 'B' Lending Industry in the State of Oklahoma*, 50 CONSUMER FIN. L.Q. REP. 452, 454 (1996). For purposes of this comment, small loan borrowers are assumed to earn less than \$20,000 per year and have less than a twelfth grade education.

15. The Department of Health and Humans Services (“DHS”) lists the greater United States poverty level at \$16,050.00 for a family of four. See Annual Update of the HHS Poverty Guidelines, 62 FED. REG. 10,856 (1997). This figure is based upon the net income of the family, and used by the federal government in determining when a family is eligible for federal assistance or services. See *id.* Extrapolating to Oklahoma, the DHS poverty guidelines accurately reflect Oklahoma's poor.

16. See CASKEY, *supra* note 4, at 14-15. Caskey's study targeted three geographic areas: Atlanta, GA, Oklahoma City, OK, and eastern Pennsylvania. For purposes of this comment, Caskey's conclusions are representative of Oklahoma's small loan borrowers.

17. See *id.*

and size during the last fifteen years.¹⁸ In Oklahoma there are approximately 710 small loan companies¹⁹ as compared to some 230 banks.²⁰

A. *Why People Borrow at High Costs*

There are several explanations why people borrow from the small loan industry despite the high cost. The most common theory is the risk factor. This theory simply asserts that the risk-screening procedures of traditional banks eliminate credit access for most lower income households by identifying them as high-risk borrowers who either have a poor credit report or no collateral to secure the loan.²¹ Denial from the traditional banking sector forces borrowers to look for alternative means of credit.²²

Additionally, there is evidence to support the claim that small loan borrowers do not fully understand the higher cost of alternative financial services,²³ despite the fact that federal truth in lending laws require lenders to make certain disclosures.²⁴ Borrowers may be confused by the many required disclosures, or simply incapable of interpreting the information.²⁵ "They'll be told sign here, sign here, sign here . . . [I]t's embarrassing for people to realize they don't understand the terms of the transaction . . . [T]hey'll tend to believe what's told [to] them orally by the sales person."²⁶ Since the average borrowers in Oklahoma have a limited education, their lack of knowledge will likely impede effective use of the required disclosure information.²⁷ If borrowers are forced to take out a loan out of sheer need and have no credit alternative, the cost of the loan will be of little concern. One small loan company employee says, "Few customer's blink over the rate . . . They need a car to get to work to pay the bills, so they do whatever they have to do . . . The higher the interest we charge, the more money the company makes and the faster we grow."²⁸ Consumer advocates also argue that today's over-abundance of credit access may induce borrowers to believe they can afford the loan. "Borrowers often fail to

18. *See id.* at 1.

19. *See* Joe Robertson, *Loan-Industry Reforms Taking Shape*, TULSA WORLD, Feb. 15, 1998, at A1 [hereinafter Robertson, *Loan-Industry*].

20. *See* Wheat, *supra* note 14, at 458.

21. *See* CASKEY, *supra* note 4, at 19.

22. *See* Kathleen Keest, *Some of the Poor Pay Even More: Is There a 'Discrimination Tax' in the Marketplace?*, CLEARINGHOUSE REV. 365, 367 (1993). *See generally* DAVID CAPLOVITZ, *THE POOR PAY MORE* (1963).

23. *See* CASKEY, *supra* note 4, at 19; *see also* Emery v. American General Finance, 71 F.3d 1343 (7th Cir. 1996) (ruling that allegations in borrower's complaint were sufficient to state a claim under state civil Racketeering Influenced and Corrupt Organization ("RICO") statute for alleged predatory lending practices).

24. *See* 15 U.S.C. §§ 1601-1667(f) (1994). The Federal Truth In Lending Act ("TILA") was enacted to allow consumers to better understand the actual cost of credit and to provide mandatory disclosures by lenders of the amount financed, the finance charge, and the APR calculated by the actuarial method or a method substantially similar. *See* 12 C.F.R. § 226 (1996).

25. *See* Robin A. Morris, *Consumer Debt and Usury: A New Rationale for Usury*, 15 PEPP. L. REV. 151, 169 (1988).

26. *Morning Edition, Credit Practices Investigated* (NPR radio broadcast, Feb. 2, 1998).

27. *See* Wheat, *supra* note 14, at 454.

28. Saul Hansell, *Loan Alley the Last Resort for Poor Credit Risks*, SAN-ANTONIO EXPRESS NEWS, Mar. 24, 1996, at D6 (quoting Diane Hunter, First Merchant's Acceptance Corp. employee, Nashville, TN).

consider important credit characteristics such as term and rates, assuming that if they can obtain credit in the judgment of the lender, they must be able to afford the repayments.”²⁹

There are also persuasive pragmatic arguments why borrowers use alternative financial sources to access credit. Small loan offices often strategically locate in low-income areas and offer longer hours of operation.³⁰ These tactics allow borrowers greater physical access to the small loan offices than to more traditional lenders.³¹ Additionally, small loan lenders’ quick approval processes make their services more attractive to borrowers.³² Typically, those seeking a small loan need an immediate source of cash. Even if borrowers were able to qualify for a loan from a traditional lender, it is unlikely their time and mobility constraints would allow for the traditional lender’s lengthier approval process.

The most compelling reason for obtaining a small loan is that given by the borrowers themselves. In a survey conducted among households with non-deposit accounts, 53% of borrowers said they did not use a deposit account because they did not have any savings.³³ Borrowers apparently believe a deposit account is not necessary since their paycheck-to-paycheck budget will not allow for any savings.³⁴ Additionally, these households cannot maintain the minimum balance that many banks require, nor can they afford the monthly charges on the account or possible returned check charges.³⁵ Therefore, low-income borrowers are often forced to seek alternative means of obtaining loans.

Because of a combination of the foregoing theories, small loan lenders have taken advantage of, albeit legally, the majority of low-income borrowers in Oklahoma. Seemingly, the mantra of the small loan industry has become: “If a customer can be taken advantage of due to lack of education, sophistication, or any real alternative in the market place, *carpe diem* is the operating principle of . . . lenders.”³⁶ That unscrupulous lenders would seek to charge extremely high interest is no surprise—that a statute would endorse such rates is shocking.

B. How Borrowers Spend Small Loans

While there is little documentation illustrating how small loan borrowers spend their loan money, the socioeconomic status of the borrowers allows a reasonable inference that a majority of the loans are used for necessities.³⁷ To better envision

29. Morris, *supra* note 25, at 169.

30. See CASKEY, *supra* note 4, at 4, 19.

31. See *id.* at 19.

32. See *id.*

33. See *id.* at 21.

34. See *id.*

35. See *id.*

36. Keest, *supra* note 22, at 365.

37. See Paul Tosto, *Lawmakers Scrutinize Practices*, THE STATE, Jan. 15, 1995, at G1 (reporting one woman’s situation when Medicaid could not cover her medical expenses she sought loans to pay for her medications); see also JOHN P. CASKEY, FRINGE BANKING CHECK CASHING OUTLETS, PAWNSHOPS, AND THE POOR 78-83 (1994) (discussing why

what the monies are used for, consider this hypothetical. Bill and Eleanor Baines have two young children and the family resides in Tulsa, Oklahoma. Both Bill and Eleanor are wage earners with a combined gross income of \$20,000.00 per year. (For a family of four, a \$20,000.00 per year before tax income is realistically, a paycheck-to-paycheck existence, allowing for little or no savings.³⁸) Assume Bill and Eleanor have one car which serves as their sole mode of transportation to and from work. The car breaks down, and the cost of repair is \$500.00. Because the family has no discretionary income, they cannot afford the repair. Without the car it will be difficult for either wage earner to get to work. If they do not go to work, they will lose their jobs. If they lose their jobs, they will not be able to provide food and shelter for themselves and their children. In order to survive, they must repair the car. Thus, the family is forced to take out a loan. The urgency of their situation and their lack of access to a traditional bank requires the family to seek out alternative financial services to meet their needs. A small loan lender offers them a loan at an effective 121% APR, as compared to a traditional bank's maximum 30% APR.³⁹ Due to the long-term consequences of not borrowing the money, Bill and Eleanor are not likely to refrain from borrowing solely on the basis of its high cost. For all intents and purposes, the loan is a necessary.

The family's predicament is reminiscent of the old circus acts in which a performer would progressively spin poles with plates atop with the object of keeping all the poles and plates spinning at once, and thereby preventing the plates from breaking. The performer would begin by spinning the first pole and plate, and progress down the line spinning each successive pole and plate. Upon spinning the last pole, the performer rushes back to the beginning of the line and re-spins the first pole. If she fails to re-spin the first pole, the lack of momentum will cause the plate to fall from the pole and break. If the family does not fix the car (or re-spin the first pole), they will lose their jobs (the second plate breaks) which in turn will cause them to lack the funds to buy food and pay bills (the third and fourth plates break), pay for shelter (the fifth plate breaks), and so on and so forth. To keep the theoretical poles spinning, Bill and Eleanor must borrow from the small loan lender, no matter what the cost.

This hypothetical is just one explanation for the rapidly expanding alternative financial services market, but most importantly it demonstrates the vulnerability of

borrowers use alternative financial services when the money is for a non-necessity purpose, and pointing to several studies that indicate non-necessity uses of money from alternative financial services are due to a desire for immediate cash at any cost). Caskey asserts:

Social scientists in this tradition do not blame the poor for their situation because they argue that the cultural values that trap them in poverty were acquired from the family or community in childhood [T]he pressures of dealing with everyday economic crises create a present-time oriented behavior. If lower-income families are more profligate or shortsighted than other families, this does not explain their economic situation. Rather, the behavior is largely a natural response to the economic situation itself.

Id. at 82-83.

38. See Annual Update of the HHS Poverty Guidelines, 62 FED. REG. 10,856 (1997).

39. See OKLA. STAT. ANN. tit. 14A, § 3-508A(2)(a)(ii) (West 1996).

typical low-income borrowers. At the very least, the increasing number of low-income households with no access to credit serves to increase market demand.⁴⁰ However, Oklahoma in particular has seen a relatively marked expansion⁴¹ due not only to demand, but also to the state's lender-friendly consumer credit laws.⁴² Whether borrowers are using the loan for necessities is arguably irrelevant.⁴³ The important fact is that the majority of borrowers classify as poor.⁴⁴ Consumer credit laws that tip the scales in favor of lenders further disadvantage an already suffering class. Ironically, the Oklahoma legislature's endorsement of the "B" loan practices are at the expense of the class needing their protection the most.

III. THE GENUS OF § 3-508B

A. Adoption of Uniform Consumer Credit Code

The Uniform Consumer Credit Code ("UCCC") was designed "'to protect consumers against unfair practices by some suppliers of consumer credit, having due regard for the interest of legitimate and scrupulous creditors,' and instructs that the Act 'be liberally construed and applied to promote its underlying purposes and policies.'"⁴⁵ The UCCC was prompted by a patchwork of small loan laws throughout the United States, and the many different and often inconspicuous methods lenders used to inform the consumer of the cost of credit.⁴⁶ The UCCC sought to institute a uniform system of laws for governing small loans which would better protect the consumer without eliminating competition in the market.⁴⁷ Indeed it has successfully done so in every state where implemented—save Oklahoma.⁴⁸

Prior to Oklahoma's adoption of the UCCC in 1969,⁴⁹ the small loan industry

40. See Timmons, *supra* note 3.

41. See Robertson, *Consumers*, *supra* note 2, at A1.

42. See *id.*; see also Marie Price, *Senators Ponder Deregulating Short Term Loan Rates*, THE JOURNAL RECORD, Apr. 29, 1997; World Acceptance Corp., Prospectus, May 25, 1993, at 11 (discussing the company's plan to further target the Oklahoma market due to the favorable lender laws allowing for higher interest rates, fees, and charges).

43. See Tosto, *supra* note 37 and accompanying text.

44. See Annual Update of HHS Poverty Guidelines, *supra* note 38.

45. KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER ("NCLC"), THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES 332 (1995) (quoting U.C.C.C. § 1.02 (1974 Model Code)) [hereinafter NCLC].

46. See *id.* at 53.

47. See U.C.C.C. §§ 1.101-9.103 (1968) (Prefatory Note to 1968 Revised Final Draft) (West 1997). In addition to protecting consumer rights, the UCCC sought to impose a uniform system for consumer credit, overcome outdated usury laws, and promote market competition. See *id.*

48. See OKLA. STAT. ANN. tit. 14A, §§ 1-101 to 1-110 (West 1969). The UCCC has been enacted in eight other states. See COL. REV. STAT. ANN. § 3-508 (West 1997); IND. CODE ANN. § 24-4.5-3-508 (West 1995); IOWA CODE ANN. § 535.2 (West 1997); KAN. STAT. ANN. § 16a-2-401 (Furse 1995); ME. REV. STAT. ANN. tit. 9-A, § 2-401 (West 1997); WIS. STAT. ANN. § 138.09 (West 1997); WYO. STAT. ANN. § 40-14-310 (Michie 1997); UTAH CODE ANN. § 70C-2-101 (1998). The majority of UCCC states adopting some form of UCCC section 3.508 have interest rates not exceeding 36%. See *id.* In the one UCCC state not adopting some form of section 3.508, the small loan statute is similar to Oklahoma's, but not as lender-friendly as Oklahoma's § 3-508B. Compare OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999) with UTAH CODE ANN. § 70C-2-101 (1998).

49. See OKLA. STAT. ANN. tit. 14A, § 1-101 (West 1969).

was sparsely regulated.⁵⁰ Although the first Oklahoma Constitution provided for a 10% maximum interest rate⁵¹ intending to compel small loan lenders to charge low rates, Oklahoma common law provided for a number of exceptions allowing a greater yield than 10% maximum interest.⁵² In 1963, the Oklahoma Supreme Court decided *Hollamon v. First State Bank of Stroud*⁵³ indicating that courts would no longer liberally apply the exceptions to the 10% maximum rate of interest.⁵⁴ This decision effectively outlawed the frequent practice of computing interest by either the discount or add-on methods,⁵⁵ common exceptions to the 10% maximum interest rate.⁵⁶ In *Hollamon*, the court established that for the purposes of determining usury, "the ten percent per annum interest maximum was to be computed on the declining balance of installment obligations."⁵⁷

The consumer credit industry believed the *Hollamon* decision would jeopardize business by causing lenders to deny credit to high-risk borrowers at the lower rates the decision required.⁵⁸ In addition to the *Hollamon* decision, the consumer credit industry feared the impending Truth in Lending Act ("TILA") of 1968⁵⁹ because the proposed federal legislation required lenders to disclose rates in terms that would reveal their violation of the maximum 10% per annum interest rates.⁶⁰ However, the proposed Federal Consumer Credit Protection Act⁶¹ ("FCCPA") would exempt states from TILA regulations that implemented substantially the same requirements as the federal law.⁶²

Since the UCCC met the TILA requirements, adoption of the Code seemed a particularly suitable remedy for Oklahoma.⁶³ Still, the 10% maximum rate per

50. See Bryce A. Baggett & Fred H. Miller, *The Oklahoma Version of the Consumer Credit Code*, OKLA. STAT. ANN. tit. 14A, §§ 1-101 to 1-110 (West 1996 & Supp. 1999) Introduction.

51. See OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

52. See Baggett & Miller, *supra* note 50, at 7.

53. 389 P.2d 352 (Okla. 1964).

54. See *id.* at 356.

55. Discount and add-on interest are methods for calculating "'precomputed' interest in which the consumer agrees to pay the total of payments, which includes both interest and principal, as opposed to agreeing to pay the principal plus interest as it accrues at a certain rate." NCLC, *supra* note 45, at 108. For a detailed discussion of these precomputed interests, see *id.* at 106.

56. See *Holloman*, 389 P.2d at 355.

57. Baggett & Miller, *supra* note 50, at 7. Declining balance allows for the more traditional interest-bearing calculation. See NCLC, *supra* note 45, at 123.

With an "interest-bearing" note, the lender sets up the loan on a "declining balances" basis. Every time a periodic payment is made, a periodic interest rate (the annual rate divided by the number of periods) is applied to the outstanding balance. The interest that is produced (plus late charges, if any) is subtracted from the payment; the remainder of the payment is applied to the outstanding balance, thereby reducing it. Each time a payment is made, the same process is repeated, until the outstanding balance is reduced to zero.

Id.

58. See *id.*

59. 15 U.S.C. §§ 1601-1667(f) (1994).

60. See Baggett & Miller, *supra* note 50, at 7.

61. 15 U.S.C. § 1681 (1994).

62. See *id.* § 1633 (1994).

63. See *id.* §§ 1601-1667(f) (1994). By enacting the UCCC, Oklahoma effectively complies with the TILA requirements. See OKLA. STAT. ANN. tit. 14A, § 3-302 (West 1996).

annum did not coincide with the UCCC interest rate provisions.⁶⁴ To allow for adoption of the UCCC, the Oklahoma legislature proposed a referendum to amend the state constitution.⁶⁵ By popular vote, the Oklahoma Constitution was amended to read:

The Legislature shall have the authority to classify loans and lenders, license and regulate lenders, define interest and fix maximum rates of interest; provided, however, *in the absence of legislation fixing maximum rates of interest, all contracts for a greater rate of interest than ten percent (10%) per annum shall be deemed usurious*; provided, further, that in contracts where no rate of interest is agreed upon, the rate shall not exceed six percent (6%) per annum.⁶⁶

The constitutional amendment allowed the Oklahoma legislature to adopt the UCCC in 1969 and thereby qualify for the FCCPA exemption.⁶⁷ In so doing, the legislature also added and amended several provisions of the UCCC to form the Oklahoma Consumer Credit Code ("OCCC").⁶⁸

A particularly interesting addition which significantly departed from the Uniform Consumer Credit Code was § 3-508B governing small supervised loans. While § 3-508A of the OCCC was largely based upon the corresponding provision in the UCCC and provides for a maximum rate of interest of 30% on supervised loans,⁶⁹ § 3-508B was modeled after a unique Texas (a non-UCCC state) statute governing small loans⁷⁰ authorizing charges that equate to interest rates as high as 300%,⁷¹ but failing to specify a maximum rate of interest for this type of loan.⁷² There is no corresponding provision in the UCCC to the Texas statute that ultimately became Oklahoma's small loan statute.⁷³ The Uniform Code proposed that state small loan statutes all be governed by what became § 3-508A of the OCCC.⁷⁴ Importantly, adopting § 3-508B was not proposed until after the 1968 constitutional amendment was in place.⁷⁵

Thus, at the time the legislature drafted the amendment to the Okla. Const. Article XIV, § 2 and at the time the people of Oklahoma overwhelmingly voted to amend

64. See Baggett & Miller, *supra* note 50, at 7.

65. See *id.*

66. OKLA. CONST. art. XIV, § 2 (amended 1968) (emphasis added).

67. See 15 U.S.C. § 1633 (1994).

68. See OKLA. STAT. ANN. tit. 14A, §§ 1-101 to 1-110 (West 1996 & Supp. 1999).

69. See U.C.C.C. § 3.508 (West 1997).

70. See TEX. REV. CIV. CODE ANN. § 5069-3.16 (West 1996).

71. Robertson, *Consumers*, *supra* note 2, at A1. Technically, it is impossible to determine how high the rates could go since nothing in the statute prohibits repeated refinancing which significantly increases the APR. See OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999); see also Plaintiffs' Combined Response, Aug. 3, 1998, *supra* note 13, at 6-10 (detailing one plaintiff's repeated loan refinancings).

72. See OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999).

73. See U.C.C.C. §§ 1.101-9.103 (West 1997).

74. See *id.* § 3.508 (setting the maximum interest rate at 36%); see also OKLA. STAT. ANN. tit. 14A, § 3-508A (West 1996) (setting the maximum interest rate at 30%).

75. See Plaintiffs' Combined Response, Aug. 3, 1998, *supra* note 13, at 18.

that section of the Oklahoma Constitution, the provisions of the Oklahoma UCCC Section 3-508B[sic]—which are found nowhere in the model Code—were nothing more than a twinkle in the eye of Oklahoma's small loan industry.⁷⁶

In adopting § 3-508B, the Oklahoma legislature effectively skirted the UCCC's attempt to protect borrowers' rights and provide uniformity in state loan laws.⁷⁷ Even worse, it disregarded the trusting will of its constituents. The Oklahoma legislature was apparently more interested in promoting the interest of the lender rather than protecting the vulnerable borrower.

B. The Oklahoma Consumer Credit Code

The OCCC defines "consumer loans" as those loans which are for purposes of personal, family, or household uses, and the debt is either payable in installments or a loan finance charge is made.⁷⁸ "Supervised loans" are those consumer loans in which the interest rate exceeds 10% per year.⁷⁹ In order to make supervised loans, a lender must either be a supervised financial organization⁸⁰ or licensed by the Administrator of the Oklahoma Department of Consumer Credit.⁸¹ "B" loan lenders are authorized to make supervised loans by license⁸² since they are not deposit institutions.⁸³ Licensed lenders are subject to oversight by the Administrator of the Oklahoma Consumer Credit Department who has the power to suspend and revoke licenses if the lender is not in compliance with the applicable OCCC provisions.⁸⁴ In order to discover other abuses, an agent of the Administrator typically inspects "B" loan lenders annually.⁸⁵ Creditors may also file complaints with the Oklahoma Department of Consumer Credit.

The Oklahoma legislature amended the UCCC provision for supervised loans by dividing it into two distinct sections. The "A" loan provision is comparable to section 3.508 of the UCCC,⁸⁶ and the "B" loan provision mirrors Texas statute § 3.16.⁸⁷ Because § 3-508B was modeled after Texas law and not the Uniform Code, terms such as "acquisition charge" and "installment account handling charges" are not defined in the relevant chapter.⁸⁸ The discrepancy in terms has caused confusion

76. *Id.*

77. See U.C.C.C. §§ 1.101-9.103 (Prefatory Note to 1968 Revised Final Draft) (West 1997).

78. See OKLA. STAT. ANN. tit. 14A, § 3-501 (West 1996).

79. See *id.*

80. See *id.* § 1-301(17)(a)-(b) (defining a supervised financial organization as "organized, chartered, or holding an authorization certificate under the laws of this state or of the United States which authorizes the person to make loans and to receive deposits, including a savings, share, certificate, or deposit account.").

81. See *id.* §§ 3-503, 3-504.

82. See *id.* § 3-501(2).

83. See Plaintiffs' Combined Response, Aug. 3, 1998, *supra* note 13 and accompanying text.

84. See OKLA. STAT. ANN. tit. 14A, §§ 3-505, 3-506 (West 1996).

85. See Wheat, *supra* note 14, at 454.

86. See U.C.C.C. § 3.508 (West 1997).

87. See TEX. REV. CIV. CODE ANN. § 5069-3.16 (West 1997).

88. See OKLA. STAT. ANN. tit. 14A, §§ 3-101 to 3-109 (West 1996 & Supp. 1999).

and strife among lenders, the administrative oversight agency, and state judges.⁸⁹ Despite the inequity and confusion surrounding the "B" loan provision, the Oklahoma legislature has repeatedly refused to repeal § 3-508B and thereby comply with the intention of the UCCC by allowing § 3-508A to regulate small loans.⁹⁰

C. The Statutory Construction of § 3-508B

Section 3-508B authorizes a loan acquisition charge and an installment account handling fee in lieu of a loan finance charge.⁹¹ While the APR can be easily calculated for each specific "B" loan, there is no maximum rate of interest for this type of loan.⁹² By contrast § 3-508A authorizes loan finance charges between 15% and 30% depending on the amount of the loan.⁹³ However, it is clear that the legislature set the maximum rate of interest for "A" loans at 30%.⁹⁴

Currently "B" loans are defined as loans which are \$660 or less, and in addition to acquisition charges (equaling 1/10 of the principal), also provides for monthly installment charges ranging from \$9.90 to \$16.50 depending on the amount of the loan.⁹⁵ The maximum amount allowable under § 3-508B is periodically adjusted for inflation according to the Consumer Price Index ("CPI").⁹⁶ Instead of the loan finance charges specified in § 3-508A, the OCCC allows "B" loan charges in the following amounts:

(1) On loans having a principal of One Hundred Dollars (\$100.00) or less, a supervised lender *may charge in lieu of the loan finance charges* specified in Section 3-508A, the following amounts:

(a) on any amount up to and including Twenty-nine Dollars and ninety-nine cents (\$29.99), a charge may be added at the ratio of One Dollar (\$1.00) for each Five Dollars (\$5.00) of principal;

(b) on any loan in an amount in excess of Twenty-nine Dollars and ninety-nine cents (\$29.99) up to and including the amount of Thirty-five Dollars (\$35.00), there shall be allowed an *acquisition charge for making the loan* not in excess of 1/10 of the amount of the principal. In addition thereto, an *installment account handling charge* shall be

89. See Memorandum from Charles E. Jones, Administrator, Oklahoma Department of Consumer Credit to Supervised Lenders (Feb. 21, 1997) (Preface to 96-84 Op. Att'y Gen.) (Oklahoma 1997); see also *infra* Part IV.

90. See H.R. 2467, 145th Leg., 2d Session (Okla. 1995) (proposing the repeal of § 3-508B).

91. See OKLA. STAT. ANN. tit. 14A, § 3-508B(1)(a)-(f) (West Supp. 1999).

92. For a further discussion of § 3-508B's failure to set a maximum rate of interest, see *infra* Part VIII.

93. See OKLA. STAT. ANN. tit. 14A, § 3-508A(2)(a)(i)-(iii) (West 1996).

94. See *id.* § 3-508A(2)(a)(i) ("The loan finance charge, calculated according to the actuarial method may not exceed the equivalent of the greater of either of the following: (a) the total of (i) thirty percent (30%) per year on that part of the unpaid balances of the principal which is three hundred dollars (\$300.00) or less"; twenty-one percent (21%) for balances between \$300 and \$1000; and fifteen percent (15%) for balances greater than \$1,000.).

95. See OKLA. ADMIN. CODE tit. 160, § 20-18 (1997).

96. See OKLA. STAT. ANN. tit. 14A, § 1-106 (West 1996).

allowed not to exceed Three Dollars (\$3.00) per month;

(c) on any loan of an amount in excess of Thirty-five Dollars (\$35.00) but not more than Seventy Dollars (\$70.00), there shall be allowed an *acquisition charge for making the loan* not in excess of 1/10 of the amount of the principal. In addition thereto, an *installment account handling charge* shall be allowed not to exceed Three Dollars and fifty cents (\$3.50) per month;

(d) on any loan of an amount in excess of Seventy Dollars (\$70.00) but not in excess of One Hundred Dollars (\$100.00), there shall be allowed an *acquisition charge for making the loan* not in excess of 1/10 of the amount of the principal. In addition thereto, an *installment account handling charge* shall be allowed not to exceed Four Dollars (\$4.00) per month;

(e) on any loan in an amount in excess of One Hundred Dollars (\$100.00) up to and including the amount of One Hundred Fifty Dollars (\$150.00), there shall be allowed an *acquisition charge for making the loan* not in excess of 1/10 of the amount of the principal. In addition thereto, an *installment account handling charge* shall be allowed not to exceed Four Dollars and fifty cents (\$4.50) per month;

(f) on any loan of an amount in excess of One Hundred Fifty Dollars (\$150.00) but not more than Two Hundred Dollars (\$200.00), there shall be allowed an *acquisition charge for making the loan* not in excess of 1/10 of the amount of the principal. In addition thereto, an *installment account handling charge* shall be allowed not to exceed Five Dollars (\$5.00) per month⁹⁷

The maximum term of any loan under this finance schedule is one month for each \$10 of the principal up to ten months, or one month for each \$20 of the principal up to ten months on loans of \$100 or more.⁹⁸ The minimum term of any loan under this finance schedule for loans more than \$29.99 is no less than sixty days, to be payable in equal installments in not less than thirty days from the date the loan is made.⁹⁹ Importantly, the finance charge authorized is deemed earned after the first sixty days of the loan term.¹⁰⁰ Under either the minimum or maximum term, borrowers are crippled by exorbitant fees and charges permitted by § 3-508B.

To illustrate, if the Baines borrow \$500.00 on January 1, for the minimum term,

97. *Id.* § 3-508B(1)(a)-(f) (emphasis added).

98. *See id.* § 3-508B(2).

99. *See id.* § 3-508B(3).

100. *See id.* § 3-508B(6). This recent amendment to the "B" loan provision prevents the lender from charging additional acquisition fees in the first sixty days. *See id.*

they pay \$291.50 on February 1 and again on March 1, for a total payback of \$583.00.¹⁰¹ The Baines' annual percentage rate is 132%.¹⁰² Given the payday-to-payday lifestyle of most small loan borrowers it is hard to imagine that even the most desperate borrower would agree to these terms. However, consumer advocates believe that lenders will push this short-term loan plan because of its high rate of return.¹⁰³ If the borrower has no feasible alternative nor the requisite knowledge to understand the loan, she may easily be manipulated into this exorbitant rate.¹⁰⁴ The Baines' choice is based on their interest in solving their immediate financial problem. The long-term problem—although still relatively short—of making the large payments does not concern them at the time they make the loan. Nothing in Oklahoma law prevents lenders from seizing on borrowers' inability to analyze the overall cost of the loan.¹⁰⁵ Critics refer to this scheme as "sucker-pricing."¹⁰⁶

Under the maximum term, if the Baines borrow \$500.00 on January 1, they pay \$71.50 on the first of every month for ten months, for a total payback of \$715.00.¹⁰⁷ The Baines' APR under the maximum term is 84%.¹⁰⁸ While the total payback is higher for the Baines, they may be more likely to prefer this plan since they may only be able to accommodate the smaller monthly payments, if any payments at all. Small lenders are quite amenable to the longer term plan as well, since it offers them multiple chances to refinance the loan and drive up the APR,¹⁰⁹ and of course, a higher profit margin. Under either term, the lender clearly has the advantage.

D. Why Not § 3-508A?

A key point in understanding the injustice of § 3-508B is recognizing that § 3-508A could govern the loans presently extended under § 3-508B.¹¹⁰ Indeed, the UCCC suggested a provision similar to § 3-508A for governing small loans¹¹¹ and to that end, consumer advocates have attempted to repeal § 3-508B.¹¹² Repealing the "B" loan provision would force finance companies to comply with § 3-508A which mandates rates no higher than 30%.¹¹³ This would be a relatively easy solution to eliminate the extremely high loan finance charges and bring Oklahoma law in line

101. These figures include a \$50.00 acquisition fee and two \$16.50 monthly installment account handling charges plus the \$500.00 principal, for total of \$583.00, or two equal payments of \$291.50.

102. This figure was calculated by the actuarial method, using an actuarial calculation program.

103. See CASKEY, *supra* note 4, at 42.

104. See NCLC, *supra* note 45, at 56.

105. See OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999).

106. See NCLC, *supra* note 45, at 56.

107. These figures include a \$50.00 acquisition fee and ten \$16.50 monthly installment account handling charges plus the \$500.00 principal, for total of \$715.00 with ten equal payments of \$71.50.

108. This figure was calculated by the actuarial method, using an actuarial calculating program.

109. Although the amended version of § 3-508B effects a sixty-day waiting period before lenders may refinance the loan, it is not foreseeable refinancing practices will decrease any substantive amount. Refinancing is how small loan companies make the majority of their profit. See Robertson, *Consumers*, *supra* note 2, at A1; *infra* Part IV.

110. See OKLA. ADMIN. CODE tit. 20, § 20-18 (1997) (setting \$3,300.00 as the maximum amount for "A" loans).

111. See U.C.C. § 3.508 (1969).

112. See H.R. 2467, 145th Leg., 2d. Sess. (Okla. 1995) (proposing the repeal of § 3-508B).

113. See OKLA. STAT. ANN. tit. 14A, § 3-508A (West 1996).

with the majority of other UCCC states' small lender laws.¹¹⁴ While a repeal of § 3-508B would decrease the industry's considerable profit margin, small loan companies operate profitably in many other states with substantially lower rates.¹¹⁵ Nevertheless, the small loan industry has effectively combated this solution by persuading the Oklahoma legislature to blatantly disregard and exploit their most vulnerable constituents.¹¹⁶

The fees authorized by § 3-508B make it difficult for even a relatively sophisticated consumer to realize the actual cost of credit.¹¹⁷ In light of the fact that small loans are available under the "A" loan provision at a 30% interest rate, it is clear that the "B" loan provision is strictly for purposes of enabling lenders to disguise the fees and take advantage of customers. If the Baines escape refinancing the loan before paying it off,¹¹⁸ they incur well over the "A" loan 30% maximum interest rate under either term. In the nine states enacting some form of the UCCC, only two allow for interest rates over 36%.¹¹⁹ Most other UCCC states provide interest ceilings closer to a 30% maximum rate of interest in § 3-508A.¹²⁰ Oklahoma is the only state that has corrupted one of the central purposes of implementing the UCCC—protecting the consumer.¹²¹

E. Obtaining a "B" Loan

"B" loans are relatively easy to obtain. Lenders require that the borrower be at least eighteen years of age, have verifiable current employment for at least one year (in the absence of year-long employment, any current employment and a co-signer

114. See, e.g., COL. REV. STAT. ANN. § 3-508 (West 1997); IND. CODE ANN. § 24-4.5-3-508 (West 1995); IOWA CODE ANN. § 535.2 (West 1997); KAN. STAT. ANN. § 16a-2-401 (Furse 1995); ME. REV. STAT. ANN. tit. 9-A, § 2-401 (West 1997); WIS. STAT. ANN. § 138.09 (West 1997); WYO. STAT. ANN. § 40-14-310 (Michie 1997).

115. See Michael Hudson, *Cashing In On Poverty*, THE NATION, May 10, 1996, at 13 (stating that national consumer-finance companies typically "earn double or triple the return on assets that banks do."); see also GREENVILLE NEWS, Apr. 25, 1998, at A6 (citing World Acceptance Corporation's operation in five other states and its 29% net income increase from 1996 to 1997); Timmons, *supra* note 3 (citing World Acceptance Corporation's 22.5% net income increase from 1995 to 1996).

116. See David Averill, Editorial, *Oklahoma's Sorry Small-Loan Law Unconscionable*, TULSA WORLD, May 21, 1995 ("That's when the loan operators went on the offensive. Loan compan[ies] . . . who make their livings dunning . . . late payers for money turned their finely honed telephone skills on the Legislature. No issue, not even the concealed weapons bill, generated more phone calls . . .").

117. See Robertson, *Consumers*, *supra* note 2, at A1.

118. Refinancing is typical on small loans. In fact the small loan industry reports that 89% of their customers refinance. See American Financial Services Association Education Foundation, *Members in the Spotlight: World Acceptance Corporation* (visited Oct. 12, 1997) <<http://www.americanfinsvcs.com/credit/sept96/15.html>>. The industry focuses on "flipping" or refinancing the loan. See Robertson, *Consumers*, *supra* note 1, at A1. Flipping is one of the best ways for lenders to make money. See *id.*

119. Compare COL. REV. STAT. ANN. § 3-508 (West 1997); IND. CODE ANN. § 24-4.5-3-508 (West 1995); IOWA CODE ANN. § 535.2 (West 1997); KAN. STAT. ANN. § 16a-2-401 (Furse 1995); ME. REV. STAT. ANN. tit. 9-A, § 2-401 (West 1997); WIS. STAT. ANN. § 138.09 (West 1997); WYO. STAT. ANN. § 40-14-310 (Michie 1997) with OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999) and UTAH CODE ANN. § 70C-2-101 (1998).

120. See, e.g., COL. REV. STAT. ANN. § 3-508 (West 1997) (imposing a 36% maximum interest rate); ME. REV. STAT. ANN. tit. 9-A, § 2-401 (West 1997) (imposing a 30% maximum interest rate).

121. See U.C.C.C. § 1.101-9.103 (Prefatory Note to 1968 Revised Final Draft) (West 1997).

will suffice), a verifiable place of residence, and three forms of collateral.¹²² To approve the loan, the lender does not perform a credit check but simply verifies the loan application information.¹²³ "In assessing the risk of loan applicants, . . . small-loan companies generally do not obtain a loan applicant's credit report."¹²⁴ After making a few calls to verify employment and residence,¹²⁵ the "B" lender will typically loan the borrower the lower range of the principal category governing the fee schedule.¹²⁶ Because the lender can charge a monthly account handling fee of \$16.50 for loans between \$495.00 and \$660.00,¹²⁷ the rate of return is higher for a \$495.00 loan than a \$660.00 loan.¹²⁸ "B" loan laws then, create an incentive for lenders to make loans at the lower range of the principal category.¹²⁹

An indicator of how easy it is to qualify for a loan is the plethora of collateral lenders accept. The following articles are acceptable collateral: automobiles with clear title (for loans over \$300.00),¹³⁰ televisions, video cameras, video tapes, computers, software, adding machines, musical equipment, exercise equipment, electronic games (i.e., Sega or Nintendo), fishing and camping equipment, guns, power tools, lawn mowers, VCRs, sports equipment, bikes, furniture, and complete luggage sets.¹³¹ Household appliances are not acceptable.¹³² In other words, collateral for the small lender is everything but the kitchen sink.

F. Lender Management of the "B" Loan

Small loan lenders incur very little risk even when lending to the highest risk borrower.¹³³ This is largely due to the fact that borrowers tend to re-pay their loans in order to preserve their sole source of credit.¹³⁴ One of the nation's largest small loan lenders, World Acceptance Corporation, "finds that most customers tend to pay up, apparently to protect their *only* source of credit."¹³⁵ Lending companies also maintain close communication with their customers often contacting them as soon as a payment is missed.¹³⁶ "Local office staff promptly contact delinquent customers

122. See Interview with Consumer Credit Company employee, in Tulsa, Oklahoma (Oct. 16, 1997) (notes on file with author).

123. See *id.*

124. CASKEY, *supra* note 4, at 32.

125. See Interview, *supra* note 122.

126. See CASKEY, *supra* note 4, at 42.

127. See OKLA. ADMIN. CODE tit. 160, § 20-18(c) (1997).

128. See CASKEY, *supra* note 4, at 42. In studying Oklahoma's small loan law Caskey's study found that when some borrowers "requested a loan greater than the lower bound in the relevant loan size category, lenders refused to make the loan. However, the lenders offered to make a cash advance equal to the lower bound of that category or the one above it." *Id.*

129. See *id.*

130. See OKLA. STAT. ANN. tit. 14A, § 3-515 (West Supp. 1999).

131. See Interview, *supra* note 122.

132. See *id.*

133. See Kenneth Cline, *Mining the Low End*, AMERICAN BANKER, May 16, 1994, at 4.

134. See *id.*

135. *Id.* (emphasis added).

136. See World Acceptance Corp., *supra* note 42, at 23.

following any payment due date and thereafter remain in close contact with such customers through placing phone calls, letters, or personal visits to the customer's residence or place of employment until payment is received."¹³⁷ (A common method of obtaining payment is actually refinancing the loan in order to advance the borrower cash to make a loan payment.)¹³⁸ In the rare case of default, the lender may enforce her security interest on the collateral or garnish the borrower's wages.¹³⁹ Tellingly, in over thirty years of business, World Acceptance Corporation has yet to report a loss.¹⁴⁰ This fact is indicative of borrowers' tendency to repay and lenders' successful collection efforts.

IV. REFINANCING UNDER § 3-508B

The plight of small loan borrowers increases when considering the frequency of refinancing. The industry often refers to refinancing as "rolling" or "flipping" the loan.¹⁴¹ World Acceptance Corporation reported that it refinanced an astounding 89% of its loans in 1996.¹⁴² Thus, small loan lenders' major source of profit comes from keeping borrowers in perpetual debt.¹⁴³ As one former Oklahoma lender said, "You keep rolling them and rolling them till you bleed them dry."¹⁴⁴ "If we never renewed the loan, we'd make very little money."¹⁴⁵

The profitability of refinancing is primarily due to two factors, non-refundable acquisition fees and the Rule of 78. The original acquisition fee is non-refundable to the consumer after sixty days.¹⁴⁶ The legality of the second acquisition fee and the rates at which "B" loans are refinanced was in dispute until the recent reforms to § 3-508B.¹⁴⁷ Section 3-205 of the OCCC requires that the refinancing interest rate not exceed the rate of the original loan and accordingly refers supervised lenders to § 3-508.¹⁴⁸ Since there is no § 3-508 in the OCCC (only § 3-508A and § 3-508B), a 1969 West Publishing Company footnote indicated the "B" loans were to be refinanced under the § 3-508A 30% maximum rate.¹⁴⁹ While the legislature adopted the footnote in recodifying the statutes in 1971, 1981, and 1991 and Oklahoma Attorney General Drew Edmonson issued an opinion interpreting the statute as indeed requiring the "B" loan lenders to refinance at the "A" loan 30% maximum rate,¹⁵⁰

137. *Id.*

138. *See* NCLC, *supra* note 45, at 190.

139. *See* OKLA. STAT. ANN. tit. 14A, §§ 5-102, 5-104, 5-105 (West 1996).

140. *See* Cline, *supra* note 133, at 4; GREENVILLE NEWS, *supra* note 115, at A6.

141. *See* Robertson, *Consumers*, *supra* note 2, at A1.

142. *See* American Financial Services Association Education Foundation, *supra* note 118.

143. *See id.*

144. Robertson, *Consumers*, *supra* note 2, at A1.

145. Tosto, *supra* note 37, at G5 (quoting Charles Walters, Chief Executive Officer, World Acceptance Corp.).

146. *See* OKLA. STAT. ANN. tit. 14, § 3-508B(6) (West Supp. 1999).

147. *See id.*

148. *See id.* § 3-205(1).

149. *See* 96-84 Op. Att'y Gen. 2 (1997).

150. *See id.* at 6.

regulatory officials and lenders ignored the footnote for nearly thirty years.¹⁵¹ Agreeing with lenders, an Oklahoma district court judge found the codified footnote inconsequential and held lenders may continue to assess charges and refinance loans causing rates well exceeding § 3-508A's 30% maximum rate of interest.¹⁵² Also siding with lenders, the 1997 legislature clarified § 3-210 by specifying the language to state that "B" loans are to be refinanced under the provisions of § 3-508B.¹⁵³ Refinancing "B" loans at the "A" loan rate would have eliminated much of the inequity that accompanies § 3-508B loans since lenders would no longer have been able to charge the acquisition charges or installment account handling fees upon refinancing.¹⁵⁴

Refinancing is also profitable to lenders because Oklahoma law uses the Rule of 78 for rebate calculation. The Rule of 78 rebates borrowers less than actuarially due.¹⁵⁵ As required by law, when an existing consumer loan is refinanced, the lender rebates to the debtor the unearned portion of the loan finance charge.¹⁵⁶ Rebates are typically calculated either by the actuarial method or the Rule of 78.¹⁵⁷ Although the most accurate method of rebate calculation is the actuarial method, it is the most difficult mathematically.¹⁵⁸ However, the increasing use of computers and modern technology allows for quick and easy actuarial calculation.¹⁵⁹ While the Rule of 78 is a relatively simple calculation, the Rule is far more advantageous to lenders than the alternative methods because there will always be a smaller rebate for consumers when the Rule of 78 is used.¹⁶⁰

The Rule of 78 calculates the fraction of the finance charge earned at any point in the loan.¹⁶¹ Rather than assuming the amount of interest earned during each interval of the loan is equal, the Rule of 78 places greater weight on the earliest intervals of the loan term, and attributes progressively less interest to later months.¹⁶² As a result, when a loan is repaid through refinancing, or any other method, the Rule of 78 credits a lender with more earned interest than is actuarially due.¹⁶³

To fully understand the detrimental effects of these financial rules consider the impact on the hypothetical Baines family. If the Baines refinance their loan under the maximum term scenario after five months, they incur an additional acquisition charge which is one-tenth of the new principal and lose the non-refundable acquisition charge

151. See Price, *supra* note 42, at 11.

152. See *id.*

153. See OKLA. STAT. ANN. tit. 14A, § 3-205 (West 1996).

154. See 96-84 Op. Att'y Gen. 4 (1997); see also *infra* Part IX and accompanying text regarding whether the courts will in fact find these charges can be calculated for interest purposes.

155. See OKLA. STAT. ANN. tit. 14A, § 3-210(3)(b) (West 1996).

156. See *id.* § 3-210(1).

157. See NCLC, *supra* note 45, at 165.

158. See *id.* at 100-01 ("Actuarial interest is calculated by applying a periodic interest rate to the outstanding balance of the unpaid principal every repayment period for the term of the loan. The reduction over time of the outstanding balance, to produce 'declining balances,' is known as 'amortization.'").

159. See *id.* at 101.

160. See *id.* at 167.

161. See NCLC, *supra* note 45, at 170 for a detailed mathematic discussion of the Rule of 78.

162. See *id.*

163. See *id.*

of \$50.00 on the former loan.¹⁶⁴ The new principal is calculated by adding the unpaid portion of the balance and the new money advanced.¹⁶⁵ Hence if the Baines refinance after the fifth month for the same \$500.00, they pay an additional \$50.00 acquisition fee with a rebate calculated by the Rule of 78 equaling \$9.00.¹⁶⁶ Thus the balance due with the rebate would be \$348.50.¹⁶⁷ (If the rebate were calculated by the actuarial method the balance due would be \$336.14.)¹⁶⁸ At the time of refinance the Baines will receive not \$500.00, but \$151.50 since the \$348.50 balance due must be subtracted from the new \$500.00 loan. The total amount now owed by the Baines is \$916.50, due in ten equal payments of \$91.65.¹⁶⁹ The new APR is 120%, which is a 36% increase from the original APR. If the Baines refinance under the same terms, yet again, their APR will be close to 200%.

Consumer advocates claim that the Rule of 78 is an anachronism that is no longer necessary due to increasingly advanced technology.¹⁷⁰ True to its apparently evasive purposes, the OCC specifically authorizes the Rule of 78 to calculate the rebate formula for "B" loans.¹⁷¹ Not surprisingly, many states have outlawed the Rule of 78 by statute.¹⁷² Section 3-508B's authorization of repeated acquisition charges and rebates calculated by the Rule of 78 make the refinancing terms some of the most harmful provisions of the "B" loan law.

Adding insult to injury, the lack of knowledge of average borrowers often causes them to misunderstand the concept of refinancing and more detrimentally, borrowers fail to realize their greatly increased cost. Because refinancing is so advantageous to lenders, rarely will lenders inform borrowers that they will not receive the full amount of the refinanced loan. Only *after* the borrowers agree to refinance will they find out that the actual cash advanced is much less than what they anticipated, and only *after* the amount and number of the borrowers' payments increase, will they realize their extended debt. Extended and misunderstood debt may ultimately lead to yet additional refinancings.

Many people in need of quick cash are easy targets, said Elsie Ellsworth of Tulsa, who . . . discovered the plight of her sister who had [refinanced] while caring for a husband who had been undergoing dialysis for kidney failure.

164. *See id.*

165. *See id.*

166. According to the Rule of 78 calculation method, the number of scheduled installments remaining after the date of refinance (5) plus 1 is divided by the number of originally scheduled installments (10) plus 1, and then multiplied by the finance charge (\$16.50). This formula equals the \$9.00 rebate owed to the borrower. If the rebate were calculated by the actuarial method, the borrower would receive a \$13.86 rebate.

167. If the Baines made five monthly payments of \$71.50 for a total of \$357.50, the remaining balance of the original loan is \$357.50. To obtain the balance due at the time of refinance, the rebate (\$9.00) is subtracted from the remaining balance of the original loan (\$357.50). Thus the balance due with the rebate is \$348.50.

168. *See* NCLC, *supra* note 45, at 100-01.

169. The total amount of the loan (\$916.50) is calculated by adding the new money advanced (\$151.50) to the principal with the fees (\$715.00) and the additional \$50 non-refundable acquisition charge.

170. *See id.* at 167.

171. *See* OKLA. STAT. ANN. tit. 14A, § 3-210(3)(b) (West 1996).

172. *See* NCLC, *supra* note 45, at 167-68.

....

When Ellsworth . . . searched through the mountain of receipts, [she] found that [her] sister had loans . . . that had been *refinanced five, six, and seven times*, with new fees and high[er] rates every time.¹⁷³

Not surprisingly, small loan lenders focus on refinancing the loan. "We want them to max out We want customers to stay in debt."¹⁷⁴ In addition to offering to refinance the loan to pay on the original loan, small lenders use other tactics to encourage refinancing. Often small loan lenders award bonuses to salespersons who encourage borrowers to refinance their loans.¹⁷⁵ Companies also keep in close contact with their customers in order to offer continuous refinancing, frequently mailing notices to borrowers informing them that extra cash is "available."¹⁷⁶ Such predatory practices persuade large numbers of borrowers to refinance.¹⁷⁷ Refinancing the loan extends the term of the loan, while also increasing the already high APR. Specifically because there is no maximum rate of interest, refinancing is one of the most dangerous aspects of small loan borrowing, and the most profitable for lenders. If the Oklahoma legislature continues to resist the repeal of § 3-508B, and if the state courts find the statute constitutional, the legislature should at the very least prohibit the use of the Rule of 78 for rebate calculation and eliminate repeated acquisition charges

V. RECENT REFORMS TO § 3-508B

The Oklahoma legislature recently amended the "B" loan provision recognizing a few of its unfair provisions.¹⁷⁸ The major reforms include amended language in the

173. See Robertson, *Consumers*, *supra* note 2, at A1 (emphasis added).

174. Robyn Taylor, *Collecting High Rates By Lending Small Amounts*, INVESTOR'S BUS. DAILY, Oct. 30, 1995, at A6.

175. See Robertson, *Consumers*, *supra* note 2, at A1.

176. See CASKEY, *supra* note 4, at 34. In *Emery v. American General Finance, Inc.*, 71 F.3d 1343 (7th Cir. 1996), the court held that allegations in the borrower's complaint were sufficient to state a civil RICO claim against lender. *See id.* at 1395. Emery filed suit against American General Finance under RICO based on the lender's predicate acts of mail fraud in connection with loans. *See id.* Chief Justice Posner wrote:

[A]ssume . . . that these employees, desiring to exploit the financial naivete of working-class borrowers, realizing that these borrowers do not read Truth in Lending Act disclosure forms intelligently, and hoping to trick them into overpaying disastrously for credit, drafted a letter that they believed would be effective in concealing the costs of refinancing. Read against this background of nefarious purpose, the letter is seen to be replete with falsehoods and half truths. "Dear Verna . . . You're a good customer. To thank you for your business, I've set aside \$750.00* in your name." She is no "Dear Verna" to them; she has not been selected to receive the letter because she is a good customer, but because she belongs to a class of probably gullible customers for credit; the purpose of offering her more money is not to thank her for her business but to rip her off

Id. at 1347.

177. See American Financial Services Association Education Foundation, *supra* note 118.

178. See OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999).

prohibition of loan splitting,¹⁷⁹ enactment of the “brick wall” provision,¹⁸⁰ prohibition of bi-weekly and semi-weekly payments,¹⁸¹ and a prohibition of a second acquisition charge for the first sixty days of the loan term.¹⁸²

A. Loan Splitting and the “Brick Wall” Provision

A loan split can occur in two ways. First the lender may attempt to split a loan amount in order to actually make two loans which effects a higher rate of return for the lender. This practice was specifically prohibited by § 3-509 of the OCC. ¹⁸³ The amendments to this section add that a lender may also not loan split by acting in concert with other lenders.¹⁸⁴ This provision attempts to prohibit lenders from loaning or refinancing only a portion of the amount requested by the borrower and sending the borrower to another lender (owned by the same parent company) to borrow or refinance the remaining amount. This type of loan splitting obviously increases the rate of return for lenders. Prohibiting lenders to act in concert, only theoretically eliminates loan splitting since many small lenders are owned by the same parent company and often housed nearby one another.

The “brick wall” provision and the amended language in the loan splitting provision are intended to work in conjunction to prohibit “in concert” loan splitting. Prior to the “brick wall” provision, many small lenders shared offices. Thus if the lender refused to lend the borrower the amount desired, possibly intending to split the loan,¹⁸⁵ the borrower could simply walk down the counter from Office A to Office B and borrow the additional amount. Regardless of the lender’s intention, this seems an obvious solution for the borrower without any suggestion by the lender.¹⁸⁶ The “brick wall” provision mandates that two offices now be separated not by a “brick wall” technically, but by at least something requiring the borrower to walk out of one office to enter the next.¹⁸⁷ Small loan companies have effectively skirted the new law

179. *See id.* § 3-509.

180. *See id.* § 3-504(9)(a).

181. *See id.* § 3-508B(3).

182. *See id.* § 3-508B(6).

183. *See id.* § 3-509.

184. *See* OKLA. STAT. ANN. tit. 14A, § 3-509 (West Supp. 1999).

185. The lender may loan the lesser amount of the principal category to gain a higher rate of return. *See supra* notes 128-29 and text accompanying notes.

186. The lender would technically be in compliance with § 3-509. *See* OKLA. STAT. ANN. tit. 14A, § 3-509 (West Supp. 1999).

187. *See* OKLA. STAT. ANN. tit. 14A, § 3-504(9)(a)(i) - (iv) (West Supp. 1999). The statute states in pertinent part:

[T]he term office shall mean a location occupied by a licensee with the following characteristics:

- (i) a manager for the office who is not common to any other supervised lender’s offices,
- (ii) a street and mailing address separate from any other supervised lender’s office,
- (iii) an entrance through which the public may access only one supervised lender’s office, and
- (iv) separation from any other supervised lender’s office by walls or otherwise and through which neither employees nor the public may pass

by housing lending offices next door to each other or in the same strip shopping center. In effect, this provision means that the borrower must now walk out of Office A, and enter Office B from the street. Because the Department of Consumer Credit only performs annual inspections, it will be difficult for the Department to discover whether lenders are continuing to split loans.¹⁸⁸ ““The law could have—and should have—been strongerThe fact that business continues as usual shows that more reforms could be passed and . . . [lenders] could still do business profitably.””¹⁸⁹ The practical effect of these minimal revisions will accomplish little, if any, increased protection for the borrower.

B. Prohibitions of Bi-Weekly and Semi-Monthly Payments and Refinancing Within the First Sixty Days

The prohibition of bi-weekly and semi-monthly payments decreases the opportunities lenders have to offer refinancing to borrowers. It also allows borrowers a lengthier amount of time both for use of the loan, and to save for loan repayment. Prohibiting lenders from refinancing during the first sixty days of the loan term decreases costs to borrowers in the event of refinancing. But because loan terms can be up to ten months,¹⁹⁰ lenders still have several additional opportunities to refinance—costing borrowers additional acquisition fees. Although this reform may ease the cost of refinancing, it will certainly not eliminate the profitable practice.

Since the enactment of the OCCC, the industry has remained a powerful lobbying force in the legislature and has effectively guarded the henhouse.¹⁹¹ Most consumer advocates believe that even the most recent reforms do not go far enough.¹⁹² Consumer advocates would ideally like to see § 3-508B repealed, thereby allowing small loans to fall under § 3-508A.¹⁹³ Oklahoma small loan lenders could still operate profitably at the maximum 30% interest rate authorized under § 3-508A.¹⁹⁴

188. See Wheat, *supra* note 14, at 460.

189. Robertson, *Loan-Industry*, *supra* note 19, at A1 (quoting consumer advocate Steven Dow).

190. See OKLA. STAT. ANN. tit. 14A, § 3-508B(2) (West Supp. 1999).

191. The only definitive study on the Oklahoma “B” loan industry was conducted by Dr. Willis J. Wheat, who besides being both the former Dean of the Business School and President of Oklahoma City University, held a position on the board of Paceco, a Duncan, Oklahoma small lending company. See Joe Robertson, *Lenders, Regulators, Relationship Termed Cozy*, (visited Oct. 12, 1997) <<http://www.tulsaworld.com>>. Wheat’s study reported:

Those individuals who are critical of the Class “B” lending industry typically claim annual percentage rates are exorbitant *while failing to take into consideration the business risk* and legitimate service that is being provided to consumers. The cost in providing this important service must be measured in dollars and cents and not solely in annual percentage rates. The Oklahoma Legislature has established the Oklahoma Department of Consumer Credit and the department in turn has created a system in which Class “B” lenders are *highly regulated* and the rates that are permitted are well defined, controlled, and disclosed to the borrower. This system of law and regulation is *serving well the State of Oklahoma and its citizens*.

Wheat, *supra* note 14, at 457 (emphasis added). Clearly, Wheat’s previous board position calls into question the objectivity of his report.

192. See Robertson, *Loan-Industry*, *supra* note 19, at A1.

193. See *supra* Part III.D.

194. See World Acceptance Corp., *supra* note 42, at 11.

Indeed offices that operate outside the state currently do so now.¹⁹⁵

VI. WHY § 3-508B?

When Oklahoma adopted the UCCC in 1969, small loan lenders lobbied heavily to protect their interests.¹⁹⁶ The industry recognized that if the UCCC were adopted in its pure form, it would not allow for the rates then charged.¹⁹⁷ Compromise obviously came in the form of § 3-508B which arguably did nothing more than legalize loan sharking.

A. Risk Theory Analysis

The “B” loan industry typically justifies the high APRs generated by its loans in several ways. Primarily, the industry maintains that because its borrowers are typically high credit risks, interest rates must reflect that risk.¹⁹⁸ This argument assumes that high-risk borrowers will not pay off the loan. The industry contends that if the rates are lowered, it will be forced out of business due to the costs of unrecovered debt.¹⁹⁹ Yet, lenders themselves admit that their customers do in fact pay off their loans.²⁰⁰ The loans “are a customer’s credit card . . . his source of liquidity . . . from payday to payday.”²⁰¹

Additionally, while chargeoff rates for small lenders are high by bank standards, lenders are able to compensate with the profit gained by charging extremely high interest rates.²⁰² In fact, World Acceptance Corporation specifically notes that the rates allowable in Oklahoma help to minimize any losses incurred not only in Oklahoma, *but also in the five other states where it maintains offices.*²⁰³ The argument that lower rates will result in a detrimental loss of profits is exceedingly tenuous, remembering that small lenders operate profitably in other states with much lower interest rates.²⁰⁴

B. Marketplace Competition Analysis

Proponents of § 3-508B contend that repealing the provision and governing small loans under § 3-508A will eliminate competition from the market.²⁰⁵ However,

195. *See id.* (reporting profitable operation in a total of six states).

196. *See* Robertson, *Consumers*, *supra* note 2, at A1.

197. *See id.*

198. *See* World Acceptance Corp., *supra* note 42, at 19; *see also* Price, *supra* note 42, at 3.

199. *See* Averill, *supra* note 116.

200. *See* Cline, *supra* note 133, at 4.

201. *Id.*

202. *See id.*

203. *See* World Acceptance Corp., *supra* note 42, at 12.

204. *See* Price, *supra* note 42, at 3 (noting that the alternative financial services industry operates profitably in Arkansas where the interest rates are some of the lowest in the nation).

205. *See id.*

the World Acceptance Corporation itself claimed:

The Company believes that pricing is not an important competitive factor in the industry, because most small loan consumer finance companies charge the maximum rate of interest allowable under applicable state laws. The Company believes that competition between small loan consumer finance companies occurs primarily on the basis of the strength of consumer relationships, customer service, and reputation in the local community.²⁰⁶

Because small loan companies generally charge the maximum charges allowable, imposing a maximum rate of interest such as that authorized under § 3-508A will not eliminate competition from the small loan market.

C. Lack of Access to Credit Analysis

“B” lenders also claim that if their services are not available, high-risk borrowers will have no access to credit. Proponents of the existing statute allege this cut off will prompt borrowers to seek illegal means of obtaining loans.²⁰⁷ There is no empirical evidence to support such a claim. “Consumer credit legislation, when originally proposed, virtually always has evoked dire predictions that consumers will be shut out of the credit market.”²⁰⁸ “These predictions almost invariably lack credible empirical evidence and fail to materialize once the legislation is adopted.”²⁰⁹ In fact, every other UCCC state adopting the recommended small loan statute²¹⁰ has a maximum interest ceiling, and no evidence suggests that these states’ consumers are suffering from lack of access to credit.

Colorado, a UCCC state, imposes a 36% maximum interest rate for loans of \$630.00 dollars or less²¹¹ and has yet to report that high-risk borrowers have no access to credit or increased rates of loan sharking.²¹² Further, a study in Arkansas revealed that despite a then state-imposed 10% usury ceiling,²¹³ credit was much more available to low-income borrowers than in states allowing a much higher interest

206. World Acceptance Corp., *supra* note 42, at 25.

207. See Fred H. Miller & James A. McCaffrey, *Oklahoma's Adventitious Amendments to the UCCC: The Experience One Year Later*, 42 OKLA. BAR J. QUAR. 30, 42 (1971).

208. NCLC, *supra* note 45, at 55 n.127 (citing G. Wallace, *The Logic of Consumer Credit Reform*, 82 YALE L.J. 461 (1971)).

209. *Id.*

210. See COL. REV. STAT. ANN. § 3-508 (West 1997); IND. CODE ANN. § 24-4.5-3-508 (West 1995); IOWA CODE ANN. § 535.2 (West 1997); KAN. STAT. ANN. § 16a-2-401 (Furse 1995); ME. REV. STAT. ANN. tit. 9-A, § 2-401 (West 1997); WIS. STAT. ANN. § 138.09 (West 1997); WYO. STAT. ANN. § 40-14-310 (Michie 1997).

211. See COL. REV. STAT. ANN. § 5-3-508 (West 1997).

212. See Telephone Interview with employee of the Colorado Department of Consumer Credit (Nov. 4, 1997) (notes on file with author).

213. See ARK. CONST. art. 19 § 13(6) (amended 1987) (changing the 10% maximum interest rate to a 17% maximum interest rate per year). Even at 17%, the Arkansas maximum interest rate is still one of the most restrictive rates in the nation.

rate.²¹⁴ "In general, so long as credit restrictions do not make consumer lending unprofitable as an over-all business, concerns that these restrictions will shut individuals out of the credit market seem greatly exaggerated."²¹⁵

Finally, an increasing number of alternative sources of credit, other than consumer finance companies, specifically seek to offer lower rates of interest to high-risk borrowers. Credit unions have begun to focus on expanding their membership by extending credit to low-income borrowers.²¹⁶ Through education and counseling, some credit unions manage credit extension to high-risk borrowers.²¹⁷ A growing number of community-based finance companies successfully extend credit at rates as low as 10% to lower income households.²¹⁸ Although these alternative services require specialized services to educate the borrower in management and maintenance of credit, the long-term effect of their ability to prevent borrowers from perpetual debt logically has a positive impact on the economy and society as a whole.²¹⁹

D. Lender Collection Options Analysis

Lender arguments are further weakened by the broad collection remedies allowed by Oklahoma law. In fact, Oklahoma offers broader collection methods than almost any other state in the nation.²²⁰ Pursuant to state law, Oklahoma small lenders can garnish wages and repossess collateral to force payment.²²¹ Because such measures are costly, lenders usually attempt to collect through aggressive methods such as repeated calling and threats to ensure that little debt goes bad.²²² Nevertheless, garnishment and repossession are legally available remedies to lenders and the mere threat of their use would seemingly serve them well. Obviously, the most advantageous method of collection for the lender is to refinance the loan and simply extend the debt.²²³ World Acceptance Corporation "allows refinancing of delinquent loans on a case by case basis for those customers who otherwise satisfy . . . credit standards."²²⁴

A range of effective collection methods, combined with high interest rates, offers the "B" lender a double remedy. Justification of high interest rates based on high credit risk borrowers is incidental, since lenders have a range of remedies to

214. See NCLC, *supra* note 45, at 56 n.128 (citing R. Peterson & G. Falls, *Impact of Ten Percent Usury Ceiling: Empirical Evidence*, (Credit Research Center Purdue University (1981))); see also Letter from Kathleen E. Keest, Staff Attorney, National Consumer Law Center, to Sue Berkowitz, So. Carolina Legal Services Assoc. 1 (Mar. 3, 1994) (on file with author).

215. NCLC, *supra* note 45, at 56 n.127.

216. See CASKEY, *supra* note 4, at 59-61.

217. See *id.* at 5.

218. See Mike Hudson, *Community Credit*, 21 SOUTH. EXP. J. POL. & CUL. 37, 39 (1993).

219. See CASKEY, *supra* note 4, at 61-62. See generally Morris, *supra* note 25, at 174, 178-79.

220. Compare OKLA STAT. ANN. tit. 14A, § 5-105 (West 1996) with UTAH CODE ANN. § 70C-2-101(1998).

221. See OKLA STAT. ANN. tit. 14A, § 5-105 (West 1996).

222. See GREENVILLE NEWS, *supra* note 115, at A6 ("In 1996, World Acceptance Corporation began tightening its policies regarding collection . . ."); see also CASKEY, *supra* note 4, at 35-36.

223. For a full discussion of lender benefits concerning refinancing, see *supra* Part IV.

224. World Acceptance Corp., *supra* note 42, at 22.

ensure that the debt will not go bad in the event the borrower defaults. If Oklahoma continues to sanction such unfriendly consumer laws like the "B" loan provision, the legislature should consider either fixing a low maximum interest rate akin to other UCCC states or limit the lender's collection remedies. The Oklahoma legislature could further serve the state's consumers by making § 3-508B subject to a usury ceiling.²²⁵

VII. THE PURPOSE OF USURY LAWS

Usury law pre-dates written history and was common throughout the United States prior to deregulation.²²⁶ The long-standing theory behind usury law is that it "protect[s] the community, as well as its individual members from the destabilizing effects of indebtedness such as debt servitude and debt oppression."²²⁷ Appropriately then, the first Oklahoma Constitution placed a 10% cap on all loans made by contract in an attempt to protect the independent farmer in the growing industrial economy.²²⁸ Any contractual loans with an interest rate higher than 10% were intended usurious.²²⁹ The waning strength of usury laws, both in Oklahoma and the rest of the United States, is largely due to America's free market ideals and the resulting deregulation of public administration.²³⁰ Early economist Jeremy Bentham articulated the argument against usury laws:

No man of ripe years and sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such a bargain, in the way of obtaining money, as he thinks fit: nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to.²³¹

Like most free market theories, Bentham's argument "presumes equal aptitude, intelligence, information, and vigor on the parts of both borrower and lender."²³² However, current studies report that "nearly 40% of the population is estimated to be functionally illiterate."²³³ To measure "quantitative literacy," one "recent literacy study used a typical advertisement for a home equity loan."²³⁴ More than half of the

225. See OKLA. STAT. ANN. tit. 14A, §§ 5-107(2), 3-605 (West 1996) (capping interest rates on all loans, other than consumer loans and those governed by § 3-508B, at 45%).

226. See Morris, *supra* note 25, at 152, 154-56.

227. *Id.* at 152.

228. See OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968). See generally WILLIAM H. MURRAY, MEMOIRS OF GOVERNOR MURRAY AND TRUE HISTORY OF OKLAHOMA Vol. II (1945).

229. See *id.*; see also *supra* Part III.A.; Baggett & Miller, *supra* note 50 and accompanying text regarding the common law exceptions to the 10% maximum interest rate.

230. See Morris, *supra* note 25, at 154-55.

231. *Id.* at 155 (quoting JEREMY BENTHAM, *Defense of Usury*, in WORKS OF JEREMY BENTHAM 3-29 (J. Bowring, ed. 1962)).

232. Morris, *supra* note 25, at 156.

233. NCLC, *supra* note 45, at 400 (citations omitted).

234. *Id.*

adults sampled knew the meaning of the acronym APR,²³⁵ 37% understood that the APR is the primary indicator of the cost of credit,²³⁶ and “only 4% of the adults could calculate how much interest would be charged.”²³⁷ The lack of knowledge of the average borrower renders the presumption that borrowers and lenders are on equal footing implausible.

Additionally, assuming that high-risk, low-income borrowers have no credit alternative, the assertion that the two are on equal bargaining planes is illogical since in effect, borrowers are left with a Hobson’s choice. Either the borrower borrows at the rates offered by the lender or she does not borrow at all.

Thus, usury laws are a necessary in protecting low-income borrowers. The drafters of the Oklahoma Constitution apparently believed this to be true as evidenced by the earlier 10% interest cap, as did the legislature evidenced by its later enactment of the 45% usury ceiling for all loans other than consumer loans.²³⁸ “B” loans are the only consumer loans with effective rates which exceed that ceiling.²³⁹ While America has largely moved away from the paternalistic argument for usury laws, the fact remains that low-income borrowers remain vulnerable to the predatory practices of small loan lenders, especially “B” loan lenders. The existing constitutional usury ceiling is basically dormant; however in questioning the constitutionality of § 3-508B, the courts have an opportunity to put its honest purposes to use.

VIII. THE CONSTITUTIONAL ISSUE

Oklahoma’s first constitution was drafted under a populist spirit which sought to protect the small independent farmer and the industrial economy.²⁴⁰ Thus the first constitution incorporated a strict usury provision, forbidding interest rates above 10% in contractual agreements and 6% in non-contractual agreements.²⁴¹ In fact, the language of the constitutional provision strongly suggests the framers never intended for the interest rate to exceed the 10% maximum interest rate.²⁴² Nevertheless, the Oklahoma Constitution was amended effectively overriding the usury ceiling, and affording the state legislature the power to define interest and fix maximum rates of interest.²⁴³ While the amended constitution paved the way for the adoption of the UCCC, voters did not anticipate non-UCCC provisions such as § 3-508B.²⁴⁴ In

235. *See id.* at 401 n.8 (citations omitted).

236. *See id.*

237. *Id.* at 400-01.

238. OKLA. STAT. ANN. tit. 14A, § 3-605 (West 1996) (excluding § 3-508B by referring to § 5-107(2) which states: “unless such rate was lawful under any provision or provisions of this Act.” *Id.* § 5-107(2)).

239. *See* OKLA. STAT. ANN. tit. 14A, §§ 3-201, 3-508A, 3-605 (West 1996).

240. *See* MURRAY, *supra* note 228.

241. *See* OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

242. *See id.* (“The legal rate of interest shall not exceed six per centum per annum in the absence of any contract as to the rate of interest, and by contract, parties may agree upon any rate not to exceed ten per centum per annum, and, until reduced by the Legislature, said rates of six and ten per centum shall be, respectively, the legal and the maximum contract rates of interest.”) (emphasis added).

243. *See* OKLA. CONST. art. XIV, § 2 (amended 1968).

244. *See* Plaintiffs’ Combined Response, Aug. 3, 1998, *supra* note 13, at 18.

passing the constitutional amendment, “[t]here is little doubt that the people of Oklahoma were demanding *honest credit laws with realistic rates of interest*.”²⁴⁵ Section 3-508B is well short of their demands, but more importantly it violates Article XIV § 2 of the Oklahoma Constitution.

Because the “B” loan provision does not fix a maximum rate of interest, § 3-508B of the OCCG is constitutionally suspect. Section 3-508B merely attaches charges to the loan which are then required to be translated into the interest rate on each loan.²⁴⁶ This simply does not meet the mandates of the Article XIV § 2 of the Oklahoma Constitution which requires the legislature to do *two* things: (1) define interest, and (2) set a maximum rate of interest.²⁴⁷ Since the amended constitution requires that in the absence of a maximum rate of interest, loans may not exceed a 10% interest rate²⁴⁸ loans made under § 3-508B are arguably subject to the seemingly dead letter usury provision. In short if there is no rate, the courts must rebate. To that end, courts must determine this issue based upon an interpretation of the constitutional language and whether the fees authorized under § 3-508B may be calculated for purposes of interest.

In fulfilling the first requirement of Article XIV § 2, the legislature defined interest as a loan finance charge²⁴⁹ for supervised loans and in § 3-508A fulfilled the second requirement by setting the maximum rate of interest at 30%.²⁵⁰ Thus for § 3-508A, the legislature fulfilled both of Article XIV’s requirements. For § 3-508B however, the legislature merely substituted the terms “acquisition fees” and “handling charges” for “finance charge” in defining interest, but failed to set a maximum rate of interest.²⁵¹ Whether these costs constitute interest is a question for the courts. Whatever the determination, it is indisputably clear that in failing to set a maximum rate of interest for “B” loans the Oklahoma legislature violated the second requirement of Article XIV § 2.

Proponents of the existing “B” loan statute argue that the constitutional language does not impose any limits on how the rates are determined.²⁵² Further, proponents contend by setting a method for calculation rather than fixing a maximum rate of interest, the Oklahoma legislature is indirectly setting rates.²⁵³ Section 3-508B advocates also claim that in order for its challengers to succeed on damage claims for rebates of moneys charged beyond the 10% usury cap, plaintiffs must concede that

245. Baggett & Miller, *supra* note 50, at 8 (emphasis added).

246. See OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999). Revealing the charges in the form of an APR is required by the Federal Truth in Lending Act. See 12 C.F.R. § 226 (1996).

247. See OKLA. CONST. art. XIV, § 2 (amended 1968).

248. See *id.*

249. See OKLA. STAT. ANN. tit. 14A, § 3-109(1)(a) (West 1996).

250. See *id.* § 3-508A(2)(a)(i).

251. See *id.* § 3-508B(1).

252. See Defendants’ Motion to Dismiss Amended Petition and Brief in Support at 10, Turner v. World Acceptance Corp., (Okla. 14th Dist. Ct. filed June 12, 1997) (No. CJ-97-1921).

253. See *id.*

the fees accompanying § 3-508B are interest.²⁵⁴ This argument is based on the fact that without the fees, the loans are virtually interest-free. This grossly misses the point, since critics of § 3-508B simply argue that the constitutional violation lies in that there is *no* maximum rate of interest at all, not whether the charges allow for the calculation of interest on each loan. To simplify, the dispute is not over whether interest can be calculated, but rather whether the Oklahoma legislature set a maximum rate of interest for the “B” loan category.²⁵⁵

A. Why §3-508B Does Not Comply with the Oklahoma Constitution

When the constitutionality of “B” loans reaches the courts it will be a case of first impression. The key question for the courts asking whether the “B” loan provision fixes a maximum rate of interest will be largely a definitional question involving a statutory interpretation of the terms “interest” and “rate of interest.” Further, because the constitution directs the legislature to both “define interest *and* fix maximum rates of interest,”²⁵⁶ a related question is whether the charges authorized under § 3-508B meet the Oklahoma legislature’s definition of interest. Ironically, courts considering similar issues have held that charges attached to a loan do not constitute interest.²⁵⁷ *Webster’s* dictionary defines the term “fix” as “to give a permanent or final form to.”²⁵⁸ While the interest rate for each individual loan may be calculated, the Oklahoma legislature failed to *fix* a maximum rate of interest for the “B” loan class as required by the constitutional amendment.²⁵⁹ The ability to merely calculate the interest on each individual loan and make the required disclosures to the consumer is simply not enough to satisfy the Oklahoma Constitution.²⁶⁰ This is true because “interest” and “rate of interest” are two separate concepts.²⁶¹ “[T]he plain, ordinary, and common meaning of the phrase ‘rate of interest’ is the rate of money paid for the use of money ‘expressed as a percentage per unit of time.’”²⁶² Although the flat charges of each loan are easily converted to a percentage charge constituting “interest,” there is no maximum rate of interest for the loans. The Oklahoma Constitution expressly mandates the legislature to *fix* a maximum *rate* of interest for each type of loan; it does not, as the Oklahoma legislature has done, allow for setting a maximum *charge* which in turn can be

254. See Group I Defendants’ Reply to Plaintiffs’ Combined Response Brief in Opposition to All Defendants’ Motions for Summary Judgment at 5, *Turner v. World Acceptance Corp.*, (Okla. 14th Dist. Ct. filed Aug. 24, 1997) (No. CJ-97-1921).

255. See Plaintiffs’ Combined Response, Aug. 3, 1998, *supra* note 13, at 20-1.

256. OKLA. CONST. art. XIV, § 2 (amended 1968) (emphasis added).

257. See *Texas Commerce Bank-Arlington v. P.A. Goldring*, 665 S.W.2d 103, 104 (Tex. 1984) (holding loan charges are not interest).

258. MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 441 (10th ed. 1995).

259. See OKLA. CONST. art. XIV, § 2 (amended 1968); OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999).

260. See OKLA. STAT. ANN. tit. 14A, § 3-302 (West 1996).

261. See Plaintiffs’ Combined Response, Aug. 3, 1998, *supra* note 13, at 21.

262. *Id.* (emphasis added) (citations omitted).

calculated as interest on each individual loan.²⁶³ Buttrressing this argument, is the fact that every other supervised consumer loan provision in the OCCC fixes a maximum rate of interest in the form of a percentage rate for each loan category.²⁶⁴ In short, the "B" loan provision's allowance of flat charges rather than fixing a maximum rate of interest violates the Oklahoma Constitution.

B. Projected Analysis of the Constitutional Issue

Since the Oklahoma courts have yet to address this issue, what will factor into the decision on the constitutionality of § 3-508B is speculative. Presumably, the courts will consider the issue against the background of the Oklahoma Constitution, its specific language, the UCCC, and relevant case law from other jurisdictions. The 1907 constitution afforded a 10% maximum interest rate by contract and provided that it only change if the Oklahoma legislature sought to *reduce* it.²⁶⁵ The 1968 constitutional amendment to Article XIV § 2 disregarded the populist intentions of the 1907 constitution to pave the way for the adoption of the UCCC.²⁶⁶ However, the amendment did not contemplate the adoption of anomalies to the Code such as § 3-508B. Clearly the people of Oklahoma did not intend for the legislature to authorize charges allowing interest rates over 300%²⁶⁷ or to nullify usury laws capable of protecting consumers from such exorbitant rates when voting for the referendum to allow for the constitutional amendment. The foundation of the Oklahoma Constitution, the purpose of the amendment, and much less, the plain language of the amendment can hardly be held to support the exploitive rates allowable under § 3-508B.

If the Oklahoma courts consider other states adopting some form of the UCCC, they will find no statute more exploitative of small loan borrowers than Oklahoma's.²⁶⁸ The UCCC was drafted to strike a compromise between efficiency and equity in the market²⁶⁹ with UCCC drafters recognizing the need for a profitable rate of return while also acknowledging the vulnerability of borrowers.²⁷⁰ While courts are not bound by the intention of the UCCC, loans made under § 3-508B are not in concert with its consumer protective spirit.

A strict interpretation of the Oklahoma Constitution clearly invalidates § 3-

263. See OKLA. CONST. art. XIV, § 2 (amended 1968).

264. See OKLA. STAT. ANN. tit. 14A, §§ 3-201, 3-508A, 3-605 (West 1996).

265. See OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

266. See Baggett & Miller, *supra* note 50, at 8; see also *supra* Part III.A.

267. See *id.* (stating that the voters demanded equitable but realistic interest rates).

268. See COL. REV. STAT. ANN. § 3-508 (West 1997); IND. CODE ANN. § 24-4.5-3-508 (West 1995); IOWA CODE ANN. § 535.2 (West 1997); KAN. STAT. ANN. § 16a-2-401 (Furse 1995); ME. REV. STAT. ANN. tit., 9-A § 2-401 (West 1997); WIS. STAT. ANN. § 138.09 (West 1997); WYO. STAT. ANN. § 40-14-310 (Michie 1997); UTAH CODE ANN. § 70C-2-101(1998). The majority of UCCC states adopting some form of UCCC section 3.508 have interest rates not exceeding 36%. See *id.* In the one UCCC state not adopting some form of section 3.508, the small loan statute is similar to Oklahoma's, but not as lender-friendly as Oklahoma's § 3-508B. Compare OKLA. STAT. ANN. tit. 14A, § 3-508B (West Supp. 1999) with UTAH CODE ANN. § 70C-2-101(1998).

269. See *supra* Part III.A.

270. See U.C.C.C. §§ 1.101-9.103 (West 1997).

508B. Article XIV § 2 mandates that the legislature fix a maximum rate of interest.²⁷¹ In the absence of such maximum rate, any interest rate above 10% is usurious.²⁷² In adopting § 3-508B, the Oklahoma legislature chose not to fix a maximum rate of interest for the “B” loan category, but instead to authorize specific charges which cannot constitutionally take the place of setting a maximum rate of interest for “B” loans. Although the threshold question is whether a maximum rate of interest was established, courts must also determine whether charges authorized by the “B” loan provision are calculable for interest purposes. By default, the charges serve as a basis for calculating interest to comply with TILA disclosure,²⁷³ however this is not definitive of whether they constitute interest. For courts to determine that “B” loan charges are not calculable for interest purposes borders on the absurd, since without the charges the loan would be interest-free. That said, considering the stronghold of small loan lobby, courts may refuse to consider “B” loan charges as interest, thereby negating the concern over the lack of a maximum rate of interest and resulting in a continual circumvention of the Oklahoma Constitution.

IX. FINANCE CHARGE AS INTEREST

It is likely that in determining the constitutionality of § 3-508B, the Oklahoma courts will address whether some or any of the fees authorized by the “B” loan provision are the equivalent of interest on the loan. If the statute is found unconstitutional, the analysis of fees as interest will be particularly necessary since it will determine the rebate to any plaintiffs basing their claim on the absence of a maximum rate of interest and thus beneficiaries of the 10% constitutional usury ceiling.²⁷⁴ Presumably, the courts will consider how Texas courts have ruled on this issue, since §3-508B was modeled after the Texas statute.

The OCCC and Texas law define interest as “the compensation allowed for the use or forbearance or detention of money or its equivalent.”²⁷⁵ Texas courts have generally held that charges such as those authorized under § 3-508B do not constitute interest and have thus refused to deem loans usurious.²⁷⁶ Apparently, for charges to be considered interest and thus calculable for usury purposes, they must be solely consideration for the lending of money. In *Texas Commerce Bank-Arlington v. Goldring*,²⁷⁷ one judge reluctantly concurred:

271. See OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

272. See *id.*

273. See 12 C.F.R. § 226 (1996).

274. See OKLA. CONST. of 1907, art. XIV, § 3 (amended 1968).

275. OKLA. STAT. ANN. tit. 15, § 246A (West 1996); TEX. REV. CIV. CODE ANN. § 5069-1.01 (West 1997).

276. See *Steadman v. Georgetown Savings & Loan Association*, 592 S.W.2d 486 (Tex. 1979) (holding commitment fees equal to 10% per annum of the loan does not constitute interest); *Greever v. Persky*, 165 S.W.2d 709 (Tex. 1942) (holding extra charges given for separate consideration other than the lending of money is not interest); *Ross v. Walker*, 554 S.W.2d 189 (Tex. 1977) (holding loan service charges for additional consideration given previously does not constitute interest).

277. 665 S.W.2d 103 (Tex. 1984).

Those business expenses of a lending institution that may be added to the debt without being called 'interest' are now without limitation. This court has held a plethora of charges can be added to the interest charged on indebtedness without being charges for the 'use, or forbearance or detention' of money.

....

Fees for obtaining a loan are not interest.

....

[S]o long as charges are for 'distinctly separate and additional consideration other than the simple lending of money' they are not interest. The rule has now been stretched to the point that if another label can be applied to the charge, it isn't interest in the eyes of the law. This is so even though the nexus of the transaction is the making of the loan, and without a loan, there would be no occasion to make any charges at all.²⁷⁸

The Texas judge's concerns that "business expenses . . . may be added to the debt without being called 'interest' are now without limitation,"²⁷⁹ are alleviated by the same court's earlier holding in *Gonzales County Savings and Loan Assoc. v. Freeman*.²⁸⁰ In *Freeman*, the court held that a 2% "loan fee" was not proven reasonable by the lender and thus constituted usury.²⁸¹ The lender argued the "loan fee" was consideration for having a permanent loan available for the borrower's benefit, and for the purposes of covering the expenses of negotiating the loan.²⁸² The *Freeman* court rejected the lender's argument and considered the substance of the transaction rather than its form in determining whether the contract was usurious.²⁸³ "Labels put on particular charges are not controlling. A charge which is in fact compensation for the use, forbearance or detention of money is, by definition, interest, regardless of the label placed on it by the lender."²⁸⁴ Such relevant precedent is an applicable rationale for the determination of whether or not the fees charged under § 3-508B can be calculated for interest purposes.

Accordingly, the court in *Goldring* found the attorney fees for the purposes of collection was consideration in addition to the simple lending of money, and therefore not interest.²⁸⁵ By contrast, the *Freeman* court held that a loan fee not attributable to any specific cost in addition to the simple lending of money was interest.²⁸⁶ The Texas Supreme Court's holdings on whether fees can be calculated as interest suggests a distinction between fees which cover specific expenses related to a

278. *Id.* at 105 (Spears, J. concurring).

279. *Id.*

280. 534 S.W.2d 903 (Tex. 1976).

281. *See id.* at 908.

282. *See id.* at 905.

283. *See id.* at 906 (citing *Schmid v. City Nat'l. Bank of Wichita Falls*, 114 S.W.2d 854 (Tex. 1938)).

284. *Id.*

285. *See Texas Commerce Bank-Arlington v. Goldring*, 665 S.W.2d 103, 104 (Tex. 1984).

286. *See Gonzales County Savings and Loan Assoc. v. Freeman*, 534 S.W.2d 903, 906 (Tex. 1976).

borrower's individual loan and expenses which cover general overhead or profit.

If the Oklahoma courts evaluate the fees allowable under § 3-508B, lenders should be required to prove that the "acquisition fees" and "installment account handling charges" are for the *specific* purpose of maintaining a particular loan. "Fees covering only overhead or profit can be challenged as hidden interest."²⁸⁷ Assuming lenders can demonstrate that the charges are specific to the borrower's contract, Oklahoma courts should question and assess whether the fee amount is reasonably related to the cost of the services provided. "Excessive charges for otherwise valid services are not actually attributable to those services to the extent they are excessive, and should be considered interest to that extent."²⁸⁸

In addition to requiring lenders to justify rates and determining the reasonableness of the rates, Oklahoma courts should weigh heavily the rationale asserted by the *Goldring* concurrence. "[The] nexus of the transaction is the making of the loan, and without a loan, there would be no occasion to make any charges at all."²⁸⁹

If the acquisition fees and account handling charges cannot be calculated for interest purposes, § 3-508B undercuts the maximum interest ceilings set out in the constitutional usury provision applicable when the legislature fails to set a maximum rate of interest.²⁹⁰ Moreover if these acquisition fees and account handling charges cannot be calculated for interest purposes, the courts in practice are refusing to enforce the Oklahoma Constitution which *requires* the legislature to fix a maximum rate of interest for every type of loan. To that end, courts must decide whether they will uphold legislation that purposely skirts the Oklahoma Constitution and is clearly violative of public policy.

X. CONCLUSION

Beyond the constitutional reasons for invalidating § 3-508B, there is a strong public policy argument to do so. Declaring the "B" loan provision unconstitutional and recognizing the charges as interest would offer consumer protection to those who need it most without eliminating access to credit. Additionally, by enforcing the dormant usury provision of the Oklahoma Constitution, courts will acknowledge the unequal bargaining power that exists between small loan lenders and borrowers, while demonstrating an intolerance for preying on the disadvantaged. Oklahoma courts have the opportunity to send a clear message to the legislature that it will no longer tolerate its cozy relationship with the small loan industry. In turn, their decision would likely prompt the legislature to reassess small loan provisions as it did after the *Hollamon* decision. After seeing the proverbial writing on the wall, the legislature may decide to govern small loans by § 3-508A similar to the more equitable provision recommended by the UCCC.²⁹¹

287. NCLC, *supra* note 45, at 206 (citations omitted).

288. *Id.*

289. *Texas Commerce Bank-Arlington v. Goldring*, 665 S.W.2d 103, 105 (Tex. 1984) (Spears, J., concurring).

290. *See* OKLA. CONST. of 1907, art. XIV, § 2 (amended 1968).

291. *See* U.C.C.C. § 3.508 (West 1997).

If Oklahoma courts do not find "B" loans unconstitutional, the legislature must repeal the statute. Thus far, the "B" loan industry has not made an effective argument to justify its exorbitant rates under § 3-508B. The lenders' risk argument is significantly diminished by industry profitability in other states with lower rates and fewer collection alternatives. Additionally, there is no empirical evidence to suggest that decreasing the rate would eliminate low-income access to credit or eliminate competition in the industry. Specifically targeting disadvantaged and unsuspecting consumers is doubly difficult to justify when § 3-508A is already in existence and would allow for lenders to make loans at a 30% maximum rate of interest while still operating profitably.²⁹² In the absence of at least *some* substantial justification, it is unconscionable for the Oklahoma legislature to condone such a law. The most obvious and equitable solution is for the Oklahoma legislature to repeal § 3-508B.

If the legislature again refuses to do so, the Oklahoma legislature must amend the statute by enacting specific reforms to achieve some consumer protection and more specifically, better protect disadvantaged borrowers. The legislature should first address the problem of refinancing since it is the most dangerous practice to borrowers. Simply by eliminating the use of the Rule of 78 for rebate calculation and allowing for a one-time acquisition charge, the legislature will reduce the small loan companies' incentive to refinance while simultaneously reducing the number of small loan borrowers drawn into perpetual debt.

Additionally, the Oklahoma legislature can equalize the bargaining power between lenders and borrowers by reforming the "brick wall" provision. Because the "brick wall" provision will have little practical effect on the deterrence of loan splitting, legislators should impose a geographic distance requirement between small loan offices and subject lenders to three annual Department of Consumer Credit inspections. Legislation should also be enacted to eliminate the lenders' double remedies, by prohibiting the use of security interests and/or wage garnishment. Finally, the Oklahoma legislature might also do well to consider investigating what particular expenses the loan charges are applied to and subsequently reduce the allowable charges under § 3-508B.

At the very least legislators should make § 3-508B subject to the 45% interest ceiling provided by § 3-605.²⁹³ In so doing, the legislature may still yet give the courts an opportunity to decide whether or not the fees authorized by the "B" loan provision are directly related to the maintenance of a specific loan, and thereby, whether the fees are reasonable. Making the "B" loan charges subject to a 45% usury ceiling, and forcing lenders to justify the charges, would afford the vulnerable low-income borrower some needed protection.

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292. See OKLA. STAT. ANN. tit. 14A, § 3-508A(2)(a)(i) (West 1996).

293. See *id.* § 3-605.

