# APPENDIX 2 – Legal Challenges to Local Payday Lender Ordinances

Often advocates find that local governments are much more approachable and willing to enact consumer protection payday loan legislation than state and federal legislators. Potential reasons for this phenomenon are that often local residents are unable to participate in statewide or national legislative actions in distant locations logistically in accessible to most citizens. Local legislation is also more widely covered by local press, putting civic leader under much more of a microscope than state legislators.

The main challenges to local legislation tend to be based upon preemption arguments (express, implied and/or conflict). Samples of specific preemption arguments involve arbitration clauses or price controls. Challenges can also be based upon procedural irregularities. Advocates can look to home rule provisions for support of local legislation and can fashion legislation that addresses gaps in state and federal legislation. Local governments generally have more leeway in enacting local land use and zoning legislation. A discussion of arguments used to defeat and support local ordinances and a discussion of home rule, land use and zoning principles follow. Lastly, a sample of court decisions addressing challenges to local ordinances regarding credit products is included below.

## Preemption Arguments

Lenders argue that local ordinances are "preempted" from enacting ordinances by pre-existing state or federal law. There are three types of preemption: 1) express or complete preemption, 2) field or implied preemption and, 3) conflict preemption. Express preemption is when the federal or state law explicitly recites intent to preempt state or local law. Field preemption applies when federal or state laws are so pervasive, that there is no room left for states or local governments to supplement them. Conflict preemption occurs when it is impossible to comply with both federal or state law and the local law, for example when a local law prohibits what a federal or state law allows.

## Express or Complete Preemption

Express preemption is often found in language contained in the "policy and legislative intent" section of the state or federal law. This language clearly prohibits enactment of ordinances or other laws to the contrary or gives exclusive jurisdiction in all matters addressed by the law to the state or federal government. The legislature usually claims the need for uniformity in the subject matter throughout the state or country.

An example of a price control express preemption is found in Florida Statutes. §125.0103:

> Except as hereinafter provided, no county, municipality, or other entity of local government shall adopt or maintain in effect an ordinance or a rule, which has the effect of imposing price controls upon a lawful business activity which is not franchised by, owned by, or under contract with, the governmental agency unless specifically provided by general law.

## Implied or Field Preemption

If there is no express preemption, there may be field or implied preemption. Implied preemption occurs when preemption is not specifically stated but the state or federal legislative scheme is so pervasive that it is deemed to "occupy the entire field of potential regulation" creating a danger of conflict between local and state laws.

Implied preemption is actually a decision by the courts to find preemption when there is no explicit legislative directive. The courts are understandably reluctant to "find" a state or federal government intent to prevent a local elected governing body from exercising its local or "home rule" powers. (*See Home Rule below).* If a state or federal legislative body can easily create express preemption by including clear language in a statute, there is little justification for the courts to interject such an intent into a statute. In the absence of express preemption, normally a court will only find implied preemption if there is a direct conflict between the state or federal law and a local law or they can reasonably find the legislative scheme is so pervasive that there is little or no room left for enacting additional laws covering the area. The court usually finds strong public policy reasons for finding such an area to be preempted by federal or state law. With implied preemption courts tend to limit the preemption to the specific area where the federal or state legislature has expressed a will to be the sole regulator.

**Conflict Preemption**

Even if there is no express or implied preemption, portions of a local ordinance that expressly conflict with state or federal law are unenforceable. It is well established that no local ordinance may specifically conflict with a federal or state law. A conflict exists when a local ordinance directly prohibits what the state has expressly licensed, authorized or required, or authorizes what the state has expressly prohibited. It is not necessarily a conflict when an ordinance imposes requirements not provided by state or federal laws. Instead, an ordinance conflicts with a federal or state law when the ordinance and the state or federal law cannot coexist. Put another way, legislative provisions conflict when in order to comply with one law you must violate another.

An ordinance is not superseded or preempted by a federal or state law where their subjects are at most only incidentally related. The fact that an ordinance covers a topic that relates to, but is not specifically covered by a subsequently enacted federal or state law dealing with the same topic, does not make the ordinance in conflict with, or repealed by, the law. Where the statute is silent, the ordinance may speak. So long as the ordinance is within the scope of municipal power and does not exceed or is not inconsistent with the new state or federal law, there is no conflict which would render the ordinance void. Courts are reluctant to find conflict unless there is a direct conflict between local legislation and state or federal law and generally indulge every reasonable presumption in favor of an ordinance's constitutionality.

Generally speaking, a properly enacted ordinance will be presumed to be valid until the contrary is shown, and a party who seeks to overthrow such an ordinance has the burden of establishing its invalidity.

**General Strategies for Avoiding Successful Preemption Challenges**

Draft your ordinance to complement preexisting state or federal law. A local ordinance has a greater chance of avoiding a successful conflict preemption challenge if the ordinance references the

potentially conflicting state or federal law as its guideline. Local authorities should determine what the state or federal law covers and how it operates so they can determine how to draft an ordinance in terms meant to "complement" the state or federal law in the area they regulate.

Draft your ordinance to fit within the exception provided to state or federal law. State and federal laws may contain gaps in coverage in the subject matter the local government seeks to regulate. For example, a state or federal law may reserve certain subjects for local regulation; draft the ordinance to fit within those subjects. Even if the state or federal law does not specifically reserve subjects for local regulation, attempt to draft the ordinance so it falls outside of the category of state or federal laws that are expressly preempted. If the ordinance deals with an area traditionally left to local governments, such as zoning, the courts may be less inclined to find preemption.

Use a statement of legislative purpose. If a state or federal law expressly preempts local ordinances enacted for a specific purpose, include a statement of legislative purpose in an ordinance to show the ordinance is enacted for a different purpose.

**Home Rule**

Home Rule is the principle of local self-government arising from a state constitutional grant of a charter or right to draft a charter that creates a structure and powers for city or county governments. The specific character of home rule varies by state. Some home rule states allow a "structural home rule" permitting communities to incorporate and create local governments. Another form of home rule is often called "functional home rule" where city or county governments can exercise power in such areas as public works, social services, and local economic development.

Advocates of the expansion of home rule claim that local control makes government more responsive, allows for flexible and innovative approaches to local problems, and relieves state legislatures of addressing local issues. Detractors claim few issues are strictly local in nature, especially as the populations of central cities decline and metropolitan areas become more important. They argue greater local autonomy may thwart cooperation among neighboring local governments and create disputes over policies involving overlapping federal, state and local jurisdictions.

An example of home rule is found in the Jacksonville, Duval County, Florida Municipal Charter. The consolidated county and city government:

> (a) Shall have and may exercise any and all powers which counties and municipalities are or may hereafter be authorized or required to exercise under the Constitution and the general laws of the State of Florida, including, but not limited to, all powers of local self-government and home rule not inconsistent with general law conferred upon counties operating under county charters by s. 1(g) of Article VIII of the State Constitution; conferred upon municipalities by s. 2(b) of Article VIII of the State Constitution; conferred upon consolidated governments of counties and municipalities by section 3 of Article VIII of the State Constitution; conferred upon counties by ss. 125.85 and 125.86, Florida Statutes; and conferred upon municipalities by ss. 166.021,166.031, and 166.042, Florida Statutes; all as fully and completely as though the powers were specifically enumerated herein.

> (b) With respect to Duval County, except as expressly prohibited by the Constitution or general laws of the State of Florida may enact or adopt any legislation concerning any subject matter upon which the Legislature of Florida might act; may enact or adopt any legislation that the council deems necessary and proper for the good government of the county or necessary for the health, safety, and welfare of the people; may exercise all governmental, corporate, and proprietary powers to enable the City of Jacksonville to conduct county and municipal functions, render county and municipal services and exercise all other powers of local self-government; all as authorized by the constitutional provisions mentioned in subsection (a) and by ss. 125.86(2), (7), and (8) and 166.021(1) and (3), Florida Statutes

**Regulating by Land Use and Location Restrictions**

Local governments have historically had jurisdiction to regulate local land use and planning ordinances couched in zoning terms. Many states have adopted comprehensive land use plans that act as a guide for cities. Often there are state and federal limitations regarding land use in special geographic locations such as coastal areas. Many cities have successfully enacted land use ordinances that limit the saturation of title and payday lenders and excluded them from certain areas of town unless allowed after a request for an exception or "variance" to local zoning laws or unless allowed by request for a "special use permit."

A variance is a device that permits a property owner to do something on the land which is prohibited by zoning laws. Variances are awarded to avoid practical difficulties or unnecessary hardships in individual cases. Generally speaking the difficulties or hardships must be a function of the nature of the land and not personal issues.

A special use permit allows the property owner to put property to a use expressly permitted by the law after obtaining a special permit. Special uses are specifically permitted under certain circumstances specified by the local government in the zoning law. This amounts to a finding that the use permitted is harmonious with neighborhood character and ought to be allowed. Special use permits are referred to by a variety of terms in local practice and court decisions. These terms include special exception use, special permit, special exception permit, conditional use permits, and special exceptions.

An example of a special use is the use of a home office or home occupation in an area zoned for single-family use. An ordinance may permit single-family homes without seeking a special use permit in a residential district and allow a home occupation upon the successful request for a special use permit. This means the local government body has concluded this special use is harmonious with the residential district, but that conditions may need to be imposed on the use to ensure that the size, layout, parking, and lighting do not adversely affect the residential neighborhood.

Generally local government staff will review the application for a variance, permit for special use or use by exception and make a recommendation to a local board which ultimately makes the decision or makes a recommendation to the city's governing body. Decisions granting or denying an application are "quasi-judicial" in nature. This means the local governmental authorities are required to explain the basis for their actions. The explanation must show the decision was not arbitrary and was based upon factors set out in the ordinances as the bases for granting or denying an application. The decision must also be based upon facts presented to the authority at a public hearing and on the record.

If these decisions are reviewed by the court, the court must determine if the decision is supported by "substantial evidence."

## Specific Judicial Challenges and Legislative Actions against Local Legislation

Milwaukee, Wisconsin Title and Payday Loan Ordinance

The court in *Title Lenders, Inc. d/b/a USA Payday Loans v. Board of Zoning Appeals*, Milwaukee County, Circuit Court, Case No. 04-000115, July 29, 2004. reviewed the City of Milwaukee Board of Zoning's decision to deny Loan Max's application to open a title loan business in an area where other title and payday loan businesses were already located. The Alderman for that area opposed the request based not upon inconsistencies with the local land use plan but because he objected to the interest rates charged. The City zoning board considered: 1) protection of public health, safety and welfare, 2) protection of property, 3) traffic and pedestrian safety and, 4) consistency with the comprehensive plan.

When Loan Max sought judicial review of the Board's decision, the court was bound by these standards: 1) whether the Board kept within its jurisdiction, 2) whether it proceeded on a correct theory of law, 3) whether its action was arbitrary, oppressive or unreasonable and represented its will and not its judgment and, 4) whether the Board might reasonably make the order or determination in question, based on the evidence.

The Board denied the special use permit because the payday loan entity: 1) attracts clientele that are in financial trouble or unable to manage money; 2) may attract robbers and other criminals to the area and, 3) did not comport with the efforts of the Department of City Development to develop the area. The Board was also concerned that there was another payday loan agency in the immediate area. The Court upheld the denial of the special use permit.

Madison, Wisconsin Payday Loan Ordinance

The Payday Loan Store filed an equal protection and due process violation claim against Madison, Wisconsin as a result of its ordinance prohibiting payday lenders from operating between the hours of 9:00 p.m. and 6:00 a.m. The District Court in *The Payday Loan Store of Wisconsin, Inc. d/b/a Madison's Cash Express v. City of Madison*, 333 F.Supp.2d 800 (W.D.Wis. 2004) upheld the ordinance finding the city was attempting to regulate location and hours of operation and not the financial terms or conditions of the loans and, therefore, was acting within its authority as a local government to regulate the "good order of the city and for the health, safety and welfare of the public."

Philadelphia, Pennsylvania Predatory Lending Ordinance

In June, 2001, Pennsylvania Governor Tom Ridge signed a state law explicitly overriding the Philadelphia Predatory Lending Ordinance. The state law specifically prohibits local governments from regulating sub-prime lending practices in Pennsylvania. The rationale was to guarantee lenders would face a uniform set of regulations throughout the state.

The ordinance regulated mortgage lending practices on loans of less than $100,000 that otherwise are covered under the federal Home Ownership and Equity Protection Act. The new state law claimed a well-developed sub-prime market was important and provided benefits and placed some restrictions on these loans. The state law provided protections already contained in HOEPA and did not require mandatory pre-loan counseling required by the ordinance when consumers obtained sub-prime loans.

Oakland, California Predatory Lending Ordinance

The California Constitution has a home rule provision: Article XI, Section 7 '[a] county or city may make and enforce within its limits all local, police, sanitary , and other ordinance regulation not in conflict with general law." Charter cities such as Oakland, California may adopt and enforce ordinances that conflict with general state laws, provided the subject of the regulation is a "municipal affair" rather than one of "statewide concern." Cal.Const., Art. XI, §5, Oak.City Charter, §106. Pursuant to California law "A conflict exists if the ordnance duplicates or is coextensive with a state law, is contradictory or inimical to the state law, or enters an area either expressly or impliedly fully occupied by general law.

Oakland's predatory lending ordinance was struck down because even thought the state Legislature did not expressly preempt the field of mortgage lending, the Court found field preemption by implication because the state law "fully occupied the field" of regulation of predatory practices in home mortgage lending. The Court found local regulation is invalid if it attempts to impose additional requirements in a field which is fully occupied by statute.

Factors California Courts consider as indicia of legislative intent to "fully occupy a field of regulation" are: 1) the subject matter has been so fully and completely covered by general law as to clearly indicate that it has become exclusively a matter of state concern, 2) the subject matter has been partially covered by general law couched in such terms as to indicate clearly that a paramount state concern will not tolerate further or additional local action or, 3) the subject matter has been partially covered by general law, and the subject is of such a nature that the adverse effect of a local ordinance on the transient citizens of the state outweighs the possible benefit to the locality. *American Financial Services Association v. City of Oakland, et al.*, 34 Cal.4th 1239 (2005)

Norwalk, California Zoning Ordinance

After the Court found Oakland's predatory lending ordinance invalid, Norwalk, California took an alternative approach to regulating pay day lending. The City Council passed a zoning ordinance limiting the number of pay day lending business allowed in the city to eight (8) and providing spacing/location limits. The ordinance grandfathered certain then-existing pay day lending businesses. City officials met with representatives of several payday lending institutions. These representatives also attended the Planning Commission and City Council meetings and did not oppose the ordinance. The ordinance was passed on February 23, 2010 and has not been challenged. It can be distinguished from many of the other ordinances because it regulates the industry from a zoning perspective, a function traditionally associated with municipalities.

Jacksonville, Florida Payday Loan Ordinance

The City of Jacksonville enacted a payday loan ordinance that reduced the interest rate to 36% per annum and added consumer protections not provided by the Florida Deferred Presentment Act. The ordinance also included distance requirements between other payday lenders and the area military bases. All sections, except those relating to zoning, were overturned by the Court in a summary final judgment. The Court found the interest rate sections of the ordinance created unlawful price controls which conflicted with a state law that expressly preempted local price control legislation. The Court also found express preemption by applying the Florida mortgage predatory lending law to payday loan transactions. The Court found the mortgage law prohibited enactment or enforcement of local laws regulating all financial entities licensed by the Florida Office of Financial Regulation. The Court also found that the

Florida Deferred Presentment Act implicitly preempted the field of payday loan legislation and, if not, there was a direct conflict between the local ordinance and state payday lending law because the local ordinance reduced the rates lenders were allowed to charge by state law.

The Court also found the arbitration provisions were preempted by the Federal Arbitration Act (FAA), rendering arbitration agreements valid and enforceable, finding the FAA's breadth is consistent with Congress's liberal federal policy favoring agreements to arbitrate. Under the FAA, which applies in both state and federal courts, states may not "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."

The Court disregarded the City's argument that payday lending involves relatively small loans and does not encompass loans that involve interstate commerce, finding that Courts, not legislatures, determine when a transaction involves interstate commerce. The Court found a legislative body may not simply declare that certain categories of transactions do not involve interstate commerce. *Advance America, Cash Advance Centers of Florida, Inc. v. The Consolidated City of Jacksonville, Florida*, In the Circuit Court, Fourth Judicial Circuit, in and for Duval County, Florida, Case No. 16-2005-CA-7025-MA, summary judgment order entered June 1, 2005 After the summary judgment order was entered the City repealed the entire ordinance including the zoning provisions which were upheld by the Court.

St. Ann, Missouri Ordinance Prohibiting Payday Lenders Within the City Limits

Sunshine Enterprises was licensed by the state to operate a business providing unsecured, under-$500 loans, but was denied a merchant's license by the City of St. Ann pursuant to a city ordinance prohibiting the operation of short-term loan establishments within the city. The ordinance defined a short-term loan establishment as a business engaged in providing short-term loans to the public as a primary or substantial element of its operations and prohibited their operations in all zoning districts of the City of St. Ann. Sunshine challenged the city's ordinance as being a complete prohibition, rather than a regulation, and therefore in conflict with state law. The Court held cities may not enact ordinances that conflict state statutes or regulations. While ordinances that are regulatory are allowed, those that prohibit activities permitted by state law are in conflict and invalid. Because the state law allowed the operation of lending businesses and the Court determined that Sunshine's primary business was lending, Sunshine was in compliance with state law and its operations could not be prohibited by the city ordinance. The Court held that it was the city's burden to show that the ordinance did not conflict with state law, and the City of St. Ann was unable to do so. *State of Missouri, ex rel. v. Sunshine Enterprises of Missouri, Inc. d/b/a Sunshine Title and Check Advance*, Case Number: SC83502, Appeal from the Circuit Court of St. Louis County, January 8, 2002.

St. Louis, Missouri Title Loan Ordinance

Missouri Title Loans appealed the denial of a permit to operate a title lending business within an area of St. Louis zoned for limited commercial purposes. The ordinance set requirements for businesses to satisfy for operation in this particular commercial zone. The St. Louis Board found that Missouri Title Loans did not satisfy those requirements. The ordinance provided the commercial district's purpose was to establish and preserve the commercial and professional facilities found useful in close proximity to residential areas, so long as the uses were compatible with the residential uses. The types of businesses allowed in the commercial district included general office uses, financial institutions, and other similar uses.

Title Loans challenged the denial of its permit by stating that it was a financial institution as defined in the St. Louis code. The Court looked to the definition of "financial institution" and

determined by state law that Title Loans was not a bank, savings and loan association, or similar to one, and therefore did not qualify as a financial institution for the purposes of the ordinance. Title Loans further alleged that it intended to use the property for general office purposes allowing it to qualify for the permit. The Court held "general offices," as used in the code, referred to general business offices where employees do not engage in regular contact with the public, and the operations of Title Loans did not fit this category.

Title Loans further argued that it qualified for a conditional use permit as allowed under a separate section of the code, claiming that it would satisfy the required standards. The code would allow a business to operate under a conditional basis if the business would contribute to the general welfare and convenience of the location, would not reduce or impair property values, and would not impact the adjacent uses or community facilities in a negative way. The Court accepted testimony from numerous sources that Title Loans would not satisfy the standards and would have an adverse impact on property values and the ability to attract other businesses to the area. Because the evidence supporting the denial of the permit was competent and substantial, the Court upheld the Board of Adjustment's decision and denied the permit. *Missouri Title Loans, Inc. v. City of St. Louis Board of Adjustment*, Case Number: ED77866, Appeal from the Circuit Court of the City of St. Louis, decided May 1, 2001.

Cleveland and Dayton, Ohio Predatory Lending Ordinances

The Ohio Supreme Court struck down the Cleveland and Dayton, Ohio predatory lending ordinances in *American Financial Services Association, et. al. v. City of Cleveland*, 858 N.E.2d 776 (Ohio 2006). The Court was reviewing predatory mortgage ordinances enacted by Cleveland and Dayton, Ohio The American Financial Services Association (AFSA) claimed these ordinances were preempted by or in conflict with the Ohio predatory lending law that mirrored the federal Home Ownership and Equity Protection Act in providing protections in high cost or high interest loans. The ordinances lowered the thresholds for loans included in the ordinance widening the restrictions and protections to more loans.

The Court was asked to determine: 1) if the state predatory lending law which did not expressly preempt local ordinances constitute such a wide ranging law so as to preempt the entire field of consumer lending regulation and bar local governments from adopting local ordinances regulating lending practices enforceable as "general laws" and, 2) does the "home rule" provision of the Ohio Constitution permit a municipality to impose on local consumer lending institutions regulatory requirements that are different from or more restrictive than the state predatory lending law as long as the local requirements are not *in conflict with* the state requirements?

Ohio's home rule law provides "Municipalities shall have authority to exercise all powers of local self-government and to adopt and enforce within their limits such local police, sanitary and other similar regulations, as are not in conflict with general laws." In their respective briefs, the key issue argued by the industry group and Cleveland is what standard the Court should apply in determining whether a local ordinance is or is not "in conflict" with the provisions of the state statute. The AFSA argued an "implied permission" standard applied claiming when the state enacts a law that sets specific numerical limits or spells out specific procedural requirements for a certain type of conduct or activity, the state law is *presumed to permit* conduct or activity that falls within the prescribed numerical limits and/or does not violate the prescribed procedure. In this case, AFSA claimed imposing the restrictions on more loans improperly included them for restrictive regulations not imposed by state law. They claimed the ordinance was unconstitutional and invalid because the city ordinance clearly "prohibits that which the state law permits."

The City of Cleveland responded that a more demanding "affirmative permission" standard should be applied. Under this standard, a local ordinance may only be voided for direct conflict with a state law if the local ordinance affirmatively permits something that the state law plainly prohibits, or the local ordinance prohibits something that the state law explicitly permits.

Cleveland argued both the state law and the Cleveland predatory lending ordinance were written in prohibitive (rather than permissive) form – meaning the text of both laws lists predatory terms and conditions that may not be imposed on borrowers. In terms of "home rule" analysis, Cleveland claimed the language of the state law could not be read to "permit" specific actions prohibited by the city ordinance because the state law did not permit anything, it only listed prohibitions.

AFSA argued that the state express preemption of all regulatory authority over commercial lending activity should be read broadly to cover all lending activity because the state law sets forth a detailed statewide regulatory scheme for oversight of mortgage and home improvement lending, including civil fines, rescission of loan contracts and other remedies that borrowers may pursue in state courts and that statewide laws provide a more necessarily uniform statewide regulation of the mortgage loan industry.

Cleveland argued because the constitution granted municipal governments power to adopt and enforce police regulations within their own borders, no state law could take away that power. In the absence of a clear and explicit contradiction between the terms of a state law and a local ordinance the Court must uphold the ordinance.

The Ohio Supreme Court answered both questions above in the affirmative and found the state law was a general law as it affects the ordinances at issue, found the ordinances conflicted with the state law and deemed the ordinances unenforceable.