A NATIONAL CONSUMER LAW CENTER REPORT

UTILITIES AND PAYDAY LENDERS: CONVENIENT PAYMENTS, KILLER LOANS

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A Report by the
National Consumer Law Center
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Cover photo: a PG&E "neighborhood payment center" in a payday loan store on Mission Street in San Francisco.

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***National Consumer Law Center** is a non-profit organization with 37 years of working experience in consumer issues, especially those affecting low-income consumers. NCLC works with and offers training to thousands of legal-service, government and private attorneys, as well as community groups and organizations representing low-income and elderly people. Our legal manuals and consumer guides are standards of the field.*

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TABLE OF CONTENTS

SUMMARY

When utilities send their customers to pay bills in the storefronts of ultra-high-cost payday lenders, those customers – typically the most financially vulnerable – become targets for predatory loans.

And the practice is widespread. A review of lists of authorized payment stations of 21 large utility chains found more than 650 licensed payday lenders.

To utilities, the use of payday lenders as authorized bill payment agents provides an inexpensive way to satisfy customers' demands for locations where they can pay utility bills in person and in cash.

Payday lenders make the deals in order to bring into their establishments potential customers for their ultra-high-cost loan products. In fact, payday lenders so covet the traffic generated by bill payment that some bypass making arrangements with utilities and offer "unauthorized" bill payment services.

Why utility customers? Because there are millions of them. And those who pay bills in person have some of the characteristics – low-income, minority, female, elderly – that make them prime targets for payday lenders.

Regulators should prohibit utilities from using payday loan stores as authorized payment centers. Utilities should discourage customers from paying bills where ultra-high-cost loans are marketed and transacted, and provide them with safe alternatives.

I. INTRODUCTION

Usually, a reporter isn't there to see.

But three years ago, as the Christmas holidays approached, the line of people in the lobby of a Belleville, Ill., store called the Loan Machine included Mike Fitzgerald, a staff writer for the local newspaper. Fitzgerald was working on a story about payday lenders: companies that provide short-term loans to borrowers who pay astronomical interest rates to get cash in a hurry.

As he stood behind customers waiting to arrange loans, Fitzgerald observed "a tall, elderly man who confessed to having trouble paying his utility bills."

The manager of the store was reassuring as she counted out three crisp, new $100 bills for her elderly customer. "It's going to be all right," she said. "It's going to be fine."

"I hope so," the man said. "I try so hard." [1]

♣

Sometimes life is hard – especially for seniors, people with low or fixed incomes and those who have lost jobs or been hit with medical emergencies. Among the difficulties they commonly face: the necessity of coming up with the money to pay utility bills and prevent shutoffs of heat or electricity. Often, those same people lack savings or ready access to credit.

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That's the sort of crunch – pressing bills and a shortage of cash – that brings payday lenders into the lives of their victims. In fact, payday lenders often argue that their services benefit their customers in a time of need.

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[1] "Cycle of Debt" by Mike Fitzgerald in the Belleville (Ill.) News-Democrat, Feb. 29, 2004.

♣

But the "benefits" of such loans come at a very high price. Interest rates typically start at 390 percent, and occasionally soar into quadruple digits. The loans may last for only a few days or weeks, but then require full and immediate payment of principal, interest and fees. And although state laws generally cap the size of a loan anywhere from a few hundred to a thousand dollars, customers facing payment deadlines frequently take out multiple loans or roll over short-term loans in order to avert default. That turns short-term loans into long-term debts with astronomical interest rates.

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Despite such harsh terms, payday lending has spread like a wildfire over the past decade, with high profits and permissive state laws fanning the flames. A recent tally found more than 24,000 payday loan outlets in 39 states.

Growth of the industry has been accompanied by a fierce scramble for customers. While payday lenders can easily set up shop in cheap storefronts, getting customers to walk through the door remains a challenge.

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This report shows how utility companies have helped payday lenders meet that challenge. Hundreds of high-cost lenders have arrangements with utilities to collect bill payments from their customers, according to a review of authorized payment locations listed on the web sites or in regulatory filings of 21 large utility companies that operate in states that allow payday lending. Other payday lenders collect bill payments without formal arrangements with utilities.[2]

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[2] Typically, payday lenders and other retail outlets that offer bill payment services without formal arrangements with utilities charge bill payers for this service.

Utility services – light, heat, a telephone – are necessities of life. Paying bills for those services are everyday transactions for many consumers.

But each transaction that occurs in a payday lending store has the potential to bring an unwary or vulnerable utility customer with an urgent need for money face to face with a "sympathetic" agent paid a commission to sell an ultra-high-cost loan. A payment choice made for convenience could be the first step on a path to crippling debt.

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Utility regulators should ensure that customers are not directed to high-cost lenders to pay bills for heat, light or telephone service. Financial regulators should ensure that payday and other ultra-high-cost lenders don't use bill payment services to market predatory loans. And utilities should work to ensure that their customers do not resort to predatory payday loans in order to come up with the money needed to pay bills.

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Breaking the chain of transactions that link utilities to payday lenders is a task that belongs on the agendas of advocates working to protect the interests of low-income utility customers as well as those working to oppose predatory lending. In an era when many regulators have embraced an ideology of deregulation and lean over backwards to be friendly to business, it will require concerted and persistent action by advocates and public support to end this potentially abusive practice.

II. FROM BILL PAYER TO HIGH-COST BORROWER

When utilities make arrangements that send customers to pay bills in storefronts operated by ultra-high-cost payday lenders, those customers – typically among the most financially vulnerable –become targets for predatory loans.

In virtually all of the nation's 115 million households, they are among the most routine, familiar and unavoidable transactions: paying monthly bills for electricity, natural gas or telephone service. Much billing and payment is done through the mail, although some consumers prefer to pay bills in person.

But recently, many utilities have sought to cut the costs of billing and payment. Some have shut down service centers, including counters where customers can pay bills. Utilities have also prodded customers to accept electronic billing and payment.[3] In some areas, credit card companies are seeking to handle payments.[4]

Still, many utility customers want – or need – to pay their bills in person. To serve those customers, utilities have frequently adopted another familiar approach: outsourcing. Throughout the country, utilities have delegated to third parties – often supermarkets, banks or drug stores – the task of collecting payments from utility customers.

While such third-party bill payment centers may not provide the range of customer services available from utility operated and staffed locations, the host businesses at least provide convenient venues for bill payment by utility customers without preying upon them.

[3] For example, at Electric Utility Consultants Inc.'s annual conference on "Billing for Utilities" in March, seven of the 13 presenters and a pre-conference workshop dealt with the benefits of online or credit card billing and payment and strategies for increasing customer acceptance.
[4] For example, see MasterCard International utility industry brochure posted at www.mastercard.com/us/wce/PDF/Utility%20Industry%20Program%20Overview_7%2006.pdf

Not so the payday lenders, which sometimes do business using carnival barker names – Cash King. The Money Place. Big Al's – and come-ons. "First Loan Free" proclaims a sign in the window of a Salt Lake City payday lender. "$$$ INSTANT CASH $$$" says the Yellow Pages ad of another.

Payday lenders offer small loans – typically a few hundred dollars – designed to appeal to customers scrambling to get their hands on some cash.

Convenience is a big selling point. The only requirements are a photo ID, a bank account and a paycheck – no need for a credit report, or to don a coat and tie to face a skeptical banker. Although getting to the counter may require a little waiting, it's often no worse than standing in line for a hamburger.

But convenience comes with a catch – interest rates high enough to shame a loan shark. Fees charged by lenders ring up costs equivalent to annual interest rates in a range from 390 percent to 780 percent and sometimes higher.[5]

In other words, to get $100 a borrower pays interest and other charges that even at the lower end of the range would accumulate nearly $400 in charges over a year. Such loans are possible in many states only because payday lenders have secured exemption from usury laws that would limit the annual charges on a similar $100 loan to $36.

And payday loans may cause more problems than they solve. The unwanted side effects of a payday loan can include bounced checks, checking account penalty fees, lost check-writing privileges, lowered credit ratings and exposure to heavy-handed and abusive debt collectors, says Jean Ann Fox, director of consumer protection for the Consumer Federation of America.

[5] "Cashed Out: Consumers Pay Steep Premium to 'Bank' at Check Cashing Outlets" by Jean Ann Fox and Patrick Woodall, Consumers Federation of America, November 2006, p. 8.

The past decade was a good one for payday lenders. Their loans are now legal in 38 states, and being made in a 39th – Arkansas – pending a court challenge to the constitutionality of that state's payday lending law.[6] The total of payday loan outlets mushroomed from 2,000 in 1995 to 24,000 currently. The industry is funded by huge mainstream financial institutions.[7] Total loan volume in 2005 of $40 billion was more than 10 times that in 1998.[8]

Because profitability depends on high transaction volume, payday lenders are sensitive to public acceptance and opinions. That has increased pressure to justify the high prices of payday loans. Lenders and their apologists do that by pointing to the risk and transaction costs involved in making small loans. A recent industry-funded study defended payday loans as "an improvement over pawn lending, loan sharks and wholly unregulated forms of credit that exist within the confines of what has been described as the 'informal economy.'"[9]

Payday lenders argue that the high cost of their loans is offset by their short duration. However, transactions are structured to trap customers in a cycle of lingering debt and recurring high fees, where borrowers repeatedly roll over "short-term" loans or trade in an existing short-term loan for a new one. Victims fork over mounds of cash to pay astronomical fees while the principal of their debt remains untouched.

In fact, few payday loans are one-time transactions. In a study of data collected by financial regulators in five states, the Center for Responsible Lending

[6] Consumer Federation of America web site at www.paydayloaninfo.org/lstatus.cfm.
[7] See Appendix.
[8] ACE Cash Express Inc., Form 10K filed with the U.S. Securities and Exchange Commission, Aug. 29, 2006, p. 5. Also, a database compiled by Steven Graves, a geography professor at California State University at Northridge tallied more than 24,000 payday lending stores.
[9] "Payday Lending: A Practical Overview of a Growing Component of America's Economy" by William O. Brown, David W. Findlay, Thomas E. Lehman, Michael T. Maloney and James T. Meehan Jr., by Consumer Credit Research Foundation, p. 4, posted at www.cfsa.net/downloads/payday_lending.pdf.

found that nine out of 10 loans went to customers who took out at least five payday loans in a year. Three out of five loans went to customers who in a year took out at least 12 payday loans![10]

A recent study by economists for the Federal Deposit Insurance Corporation found a similar pattern. In 2005, more than half of the customers of two payday lending chains took out seven or more payday loans annually. Although their report defended the high interest rates charged by payday lenders as justified by their costs and risks, even the cautious economists warned that "there seems little doubt that the payday advance as presently structured is unlikely to help people regain control of their finances if they start with serious problems."[11]

The way to their industry's rapid growth has been prepared by payday lenders' aggressive lobbying and big campaign contributions.[12] The resulting clout has helped lower legal barriers, and cleared the way for payday lenders to post high profits and attract additional investments.

But warnings from consumer advocates have raised awareness of the financial peril posed by payday lenders. Reports by the National Consumer Law Center and others that highlighted the concentration of payday lenders at the gates of army, air force and navy bases led to the passage of a 2006 law that puts a 36 percent interest rate ceiling on loans to military personnel.[13]

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[10] "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year" by Uriah King, Leslie Parrish and Ozlem Tanik, Nov. 30, 2006, Center for Responsible Lending, p. 6.
[11] Mark Flannery and Katherine Samolyk, "Payday Lending: Do the Costs Justify the Price?" Federal Deposit Insurance Corp. Center for Financial Research, Working Paper 2005-09, June 2005, p. 20, posted at www.chicagofed.org/cedric/files/2005_conf_paper_session1_flannery.pdf.
[12] See "Political Payday" by Scott Jordan, March 9, 2007, National Institute on Money in State Politics, www.followthemoney.org.
[13] "In Harm's Way at Home: Consumer Scams and the Direct Targeting of America's Military and Veterans" by Steve Tripoli and Amy Mix, May 2003, National Consumer Law Center.

Payday lenders have fought back. Their trade association recently launched a $10-million public relations campaign, complete with a business-friendly code of "best practices."[14] On the Plexiglas window behind which the clerks of Check City, a Salt Lake City payday lender, dole out loans, two signs urge customers to line up politically with the payday lenders. "Your financial rights are under attack," one declares. "Are you ready to have someone else control *your* access to money?" asks another.

Of course, the "financial right" to transact loans with annual interest rates of 400 percent is one that most consumers could live without – unlike the payday lenders. As a recent financial filing by a leading payday lender notes, "Media reports and public perception of short-term consumer loans as being predatory or abusive could materially adversely affect our business."[15]

Cars parked outside a payday loan store in Salt Lake City.

[14] Community Financial Services Association web page at www.cfsa.net/public_education_campaign/public_education_home.html.
[15] ACE Cash Express, Form 10K, Aug. 29, 2006, p. 28.

WHO ARE THE PAYDAY LENDERS

High profits and low barriers to entry – including permissive state laws and the small amount of money required upfront – have drawn plenty of mom and pop operators and small regional chains to the payday lending industry.

But giant players dominate. Ten large companies, including some with stocks listed on major exchanges, own or operate an estimated 40 percent of the nation's payday loan stores.[16]

Among the industry leaders is Overland Park, Kansas-based QC Holdings Inc., which operates more than 600 Quick Cash and other payday loan stores in 25 states.[17] QC may not be a household name but it is backed by Minneapolis-based U.S. Bancorp, the nation's sixth largest commercial bank, which provides QC with a $45-million line of credit.[18] QC raised $70 million in its 2004 initial public offering of shares.[19]

In May, QC wowed Wall Street and sent its stock price soaring more than 20 percent when it posted first quarter results that included a 26 percent gain in revenue, to $48.5 million, and a 36 percent increase in profits, to $3.4 million.[20]

Those strong results came even as QC faced new restrictions on its business. In its own backyard, the Overland Park City Council unanimously approved in March an ordinance imposing new licensing requirements and density ceilings on payday lenders.[21] And nationally, QC and the rest of the payday lending industry were hit with the ban on payday loans to military personnel.

The industry has counterattacked. For example, QC kicked in $750,000 to support a $10-million public relations offensive by the payday lending industry.

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[16] ACE Cash Express, Form 10K, Aug. 29, 2006, p. 6.
[17] QC Holdings Inc., Form 10K filed with the U.S. Securities and Exchange Commission, March 14, 2007, p.1.
[18] Ibid., p. 49, exhibit 10.12.
[19] Ibid, p. 1.
[20] "QC Hldgs 1Q Net Rises On 26% Higher Revenue" by Veronica Dagher, Dow Jones Newswires, May 3, 2007.

That campaign aims to convince the public that "payday loans are a necessary product delivered responsibly to customers who understand their alternatives," QC chief operating office Darrin Anderson told investors in a conference call. With that campaign underway, Anderson said, "I feel a lot better than six months ago."[22]

Owners and executives of payday loan companies may also be feeling chipper thanks to another trend that has touched the industry: leveraged buyouts by deep-pocketed Wall Street investors.

ACE Cash Express was just taken private in a $420-million leveraged buyout arranged and financed by Bear Stearns & Co., a leading Wall Street investment bank.

The deal left ACE in the hands of JLL Partners, a New York based private equity company.[23]

The buyout greatly reduced ACE's obligation to publicly disclose details of its business and finances. However, filings at the time of the buyout showed that ACE operated with the backing of a $200-million revolving credit from Wells Fargo & Co, the nation's fourth-largest commercial bank.

In the holiday spirit, Wells Fargo also backed ACE with a $75 million credit line for use at the end of the year and during tax season.[24]

[21] See City Council action summary at http://www.opkansas.org/_Gov/Agenda_Archive/Action_Summaries/2007/03_19_07.cfm.
[22] May 3, 2007 conference call with investors posted on QC Holdings web site at http://www.qcholdings.com/investor.aspx?id=1.
[23] ACE Cash Express, Schedule 14A filed with the U.S. Securities and Exchange Commission, Aug. 29, 2006.
[24] ACE Cash Express, Form 10K filed Aug. 29, 2006, p. 54.

III. UTILITIES’ PREDATORY COUSINS

While the idea of going to a payday lender to pay a utility bill may seem strange to some, there are plenty of opportunities to do so. A review of the web sites and regulatory filings of 21 large utility companies found more than 650 licensed payday lenders included on lists of utility authorized payment stations.

When residents of Salt Lake City want to find a place to pay their utility bills, they can search the web sites of Rocky Mountain Power Co., the local electricity provider, or Questar Inc., the local natural gas seller.

Each web site lists several authorized bill payment locations in Salt Lake City. Included on the lists of both companies is All Types Check Cashing, a nondescript storefront across the street from the Frank E. Moss Federal Courthouse. There, a sign on the counter has a simple suggestion: “Ask me about our payday loans.”

Of course, not everyone follows such suggestions. But, according to Steve Malia, a local movie extra who cashes checks and pays cell phone bills at All Types, store employees don’t leave it at that. At least twice, a clerk conducting a transaction has given him a “soft sell” pitch for a payday loan. So has Malia become a borrower? No, he says: “I can’t afford it.”

At All Types, and at hundreds of other payday loan stores across the country, utility customers’ economic health is in danger every time they go to pay a bill. They may inquire about a payday loan. A commission-driven seller may suggest one.[25]

[25] ACE Cash Express’ Form 10K notes that store employees compensation is partially based on achievement of operational goals that include “increase the number of daily loan transactions.” QC Holdings’ 10K notes branch expenses in 2004 rose in part due to “higher bonuses for employees … in recognition for improvements in branch gross profit.” The Form 10K filed March 1 by Advance America Cash Express says that employees are “evaluated and compensated, in part, based on their achievement of operational goals” that include “compliance with applicable laws and regulations, meeting stated growth objectives and meeting collection targets.”

Even if the customer has enough money to pay the current bill, a sales lead may have been generated for a future predatory loan.

Or an idea may have been planted in the mind of a potential borrower. Victor Laird, a Las Vegas delivery manager, told a reporter recently that payday loans are there "for emergencies like paying utility bills, especially during the summertime when the bills are a lot higher." [26] That's an association that payday lenders would like to create in the minds of as many potential customers as possible.

Available data offers no way to measure how many utility bill payers have been put on the road to becoming payday loan customers. What is certain is that many ultra-high-cost lenders double as utility bill collection agents. In a review of authorized bill payment stations listed in a regulatory filing by PG&E Corp. and on the web sites of 21 other utilities that do business in states that allow payday lending, the National Consumer Law Center identified more than 650 licensed payday lenders.

PG&E., California's largest utility, lists 71 payday lenders as "neighborhood payment centers" for its customers.[27] "The goal of our neighborhood payment centers is to find right-down-the-street locations that are convenient locations for our customers," said Jon Tremayne, a PG&E spokesman. The company also looks for sites where "customers can accomplish more than just one task," he said.

Marked by a window sign with the familiar blue and yellow PG&E logo, a neighborhood payment center in San Francisco is an ACE Cash Express store that sits a half block from a rapid transit station in an eclectic commercial district of pawn shops, sex stores, upscale restaurants and a Pilates studio.

[26] "Borrowers Beware" by Steve Kanigher, Las Vegas Sun, March 6, 2005.
[27] List of PG&E neighborhood payment stations compiled by the Utility Reform Network from filings with the California Public Utility Commission. List of payday lenders compiled by Steven Graves, professor of geography, California State University at Northridge.

Among the tasks that can also be accomplished while paying a PG&E bill at the ACE store: apply for a loan of up to $255, secured by the customer's paycheck, at an annual percentage rate of 404 percent.

PG&E's customers are among many across the country who are sent to payday loan stores to pay bills. Each of the nine third-party payment centers authorized by Tucson Electric Power Co. is an ACE Cash Express store with a payday lender license.[28] Half of the 62 third-party payment stations authorized by Indianapolis Power & Light[29] and half of the 50 authorized by San Diego Gas & Electric are payday lenders.[30]

Telephone companies have similar deals with payday lenders. Bell South, a regional telephone company recently acquired by AT&T Corp., has a network of "preferred payment agents" that includes 206 licensed payday lenders in seven states. ACE Cash Express' corporate web site invites customers to come in to pay telephone bills from T-Mobile, Verizon Wireless and Sprint PCS.

"It's all about convenience," says Tremayne, the PG&E spokesman.

But while going to a payday lender to fork over the money for heat, light or phone service may be convenient for some customers, that convenience can sometimes be very expensive. A Gallup, N.M., restaurant cashier who borrowed $200 from a payday lender to pay her electric bill because "it was so easy to do" ended up carrying the loan for six months and paying $510 in fees.[31]

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[28] Tucson Electric Power Co. web site at http://www.tucsonelectric.com/Customersvc/PaymentOptions/PaymentLocations.asp#ACE.

[29] Indianapolis Power and Light Co. web site at www.iplpower.com/ipl/index?page=IPLGeneral&Menu=01000000&DocID=0205016c163f01078f72b731006fe4.

[30] San Diego Gas & Electric Co. web site at www.sdge.com/customer/paymentlocations.shtml.

[31] "Seductively Easy, 'Payday Loans' Often Snowball" by Erik Eckholm, New York Times, Dec. 23, 2006.

Licensed Payday Lenders Listed as Authorized Bill Payment Stations by Utilities

UTILITY	STATE	PARENT COMPANY	PAYDAY LENDER BILL PAYMENT AGENTS
Indianapolis Power & Light Co	IN	AES Corp.	31
		AES Corp. Total	31
Public Service Co of Oklahoma	OK	American Electric Power Co	2
Appalachian Power Co	VA	American Electric Power Co	3
Indiana Michigan Power Co	IN	American Electric Power Co	4
AEP Ohio	OH	American Electric Power Co	44
		American Electric Power Co Total	53
Aquila	CO	Aquila Inc	6
Aquila	MO	Aquila Inc	6
Aquila	KS	Aquila Inc	10
		Aquila Inc Total	22
BellSouth	SC	AT&T	4
BellSouth	KY	AT&T	6
BellSouth	LA	AT&T	18
BellSouth	AL	AT&T	35
BellSouth	MS	AT&T	39
BellSouth	TN	AT&T	45
BellSouth	FL	AT&T	59
		AT&T Total	206
Avista Utilities	WA	Avista Corp	1
Avista Utilities	ID	Avista Corp	2
Avista Utilities	OR	Avista Corp	4
		Avista Corp Total	7
Dominion Virginia Power Co	VA	Dominion Corp	35
		Dominion Corp Total	35
Louisville Gas & Electric Co	KY	E.ON	4
Kentucky Utilities Inc.	KY	E.ON	6
		E.ON Total	10
Ohio Edison	OH	FirstEnergy Corp	29
		FirstEnergy Corp Total	29
Kansas City Power & Light	MO	Great Plains Energy	3
		Great Plains Energy Total	3
Northern Indiana Public Service Co	IN	NiSource Inc.	16
		NiSource Inc. Total	16
NorthWestern Energy	MT	NorthWestern Corp	11
		NorthWestern Corp Total	11

Pacific Power	OR	Pacificorp	3
Rocky Mountain Power	UT	Pacificorp	24
		Pacificorp Total	27
Pacific Gas & Electric Co	CA	PG&E Corp.	71
		PG&E Corp. Total	71
Arizona Public Service Co	AZ	Pinnacle West Capital Corp	12
		Pinnacle West Capital Corp Total	12
Portland General Electric	OR	Portland General Electric Co	1
		Portland General Electric Co Total	1
Puget Sound Energy Group	WA	Puget Energy Inc	24
		Puget Energy Inc Total	24
Questar	UT	Questar Corp	17
		Questar Corp Total	17
San Diego Gas & Electric Co	CA	Sempra Energy Corp	25
		Sempra Energy Corp Total	25
Nevada Power Co	NV	Sierra Pacific Resources	21
		Sierra Pacific Resources Total	21
Tucson Electric Power Co	AZ	Unisource Energy Corp	9
		Unisource Energy Corp Total	9
Xcel Energy	CO	Xcel Energy Inc	32
		Xcel Energy Inc Total	32
GRAND TOTAL			**662**

[Note on methodology:

During March and April, NCLC identified payday lenders that act as authorized utility bill payment agents by reviewing lists of such agents posted on utility web sites and then cross checking them against lists of payday lenders licensed by state financial regulators. In the case of PG&E, the Utility Reform Network provided a list of third-party bill payment stations based on filings by the in a recent rate-setting case. Altogether, we compiled lists of authorized bill payment agents for 21 utility holding companies with 36 operating utility units in 21 states. Those lists were then checked against lists of licensed payday lenders in those states gathered and compiled by Professor Steven Graves of California State University at Northridge.]

The 39 states that allowed payday lending as of April 2007 are identified on a web site developed by Jean Ann Fox of the Consumer Federation of America: www.paydayloaninfo.org.

Companies with interactive web sites that require customers to search for bill payment location by city or zip code generally weren't included in the study, nor were companies whose lists of payment locations were not easily transferred to Microsoft Excel files.

IV. MARRIAGE OF CONVENIENCE: UTILITIES SEEK SAVINGS

Utilities make deals with third parties – including payday lenders – as an inexpensive way to satisfy their customers' demands for locations where they can pay bills in person and in cash. Despite utilities' efforts to promote electronic commerce and shut down bricks-and-mortar service centers, some customers prefer to pay bills in person and find it inconvenient or impossible to travel far to do it.

Utilities, facing mounting pressures to cut costs, have sought savings by stemming the tide of paper bills and checks historically required to keep revenue flowing.

Outside vendors have stepped forward to promote alternative means of billing and payment. E-commerce entrepreneurs suggest the use of electronic transactions. Credit card companies tell utility managers that plastic could handle a lot of the $100-billion they collect annually.

But such solutions remain a long way from completely replacing traditional ways of sending out bills and making payments. Electronic commerce requires access to a computer, and not all utility customers are so wired. Credit card transactions add some costs, and aren't available to all customers.

So, despite the efforts of utilities to persuade them otherwise, some customers continue to choose to go somewhere not too far away to pay their bill to a live person. Nationwide, nearly one in four utility bill payments are made in person, according to Dennis Smith of Chartwell Inc., an industry research firm.[32] Some

[32] Telephone interview.

customers prefer to pay with cash, especially those for whom banking services are not available or affordable.

An industry survey found in-person bill payment growing at a 5 percent annual rate, with an estimated 1.1 billion transactions in 2006 expected to reach 1.3 billion by 2010. [33]

Much of the continuing demand for in-person bill payment comes from the lower level of what Jean Ann Fox of the Consumer Federation of America terms "a two-tiered system with consumers segregated by income and financial sophistication."[34] People with lower than average incomes, education and wealth, as well as minorities, are less likely to have bank accounts than other Americans. Similarly, the communities where they live may have limited banking services.[35]

There is evidence that demand for in-person bill payment is strongest among low-income, minority and female customers. A 2004 study by Pacific Gas & Electric Co., a California utility with 5 million customers, described the company's in-person bill payers as "lower income types, and credit averse individuals who have no other means of payment than cash." (Other reasons that customers cited for choosing in-person bill payment included convenience, comfort, a reluctance to pay for a stamp or a need for assurance that a payment is posted quickly in order to avoid a shut-off, according to the study).[36] A later study found that three out of five PG&E customers

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[33] Data provided by CheckFree Corp. from a March 2006 report by the Aite Group: "Walk-in Bill Payments: The Prepaid Storm."

[34] "Cashed Out," p. 2.

[35] "Who is Unbanked and Why?" by Todd Vermilyea and James A. Wilcox, May 2002, paper presented to the Federal Reserve Bank of Chicago Conference on Bank Structure and Competition., posted at www.chicagofed.org/news_and_conferences/conferences_and_events/files/2002_bank_structure_who_is_unbanked_and_why.pdf

[36] PG&E 2007 General Rate Case Phase 1, PG&E Exhibit 5, workpapers p. 6AB-20, filed with California Public Utilities Commission.

who paid their bills in person had incomes of less than $35,000, and that the same proportion were women. Two out of five were black or Hispanic.[37]

Despite the results of that study, PG&E recently asked state regulators for permission to close all 84 of its company operated and staffed pay stations. PG&E said that in 2004 those offices had about 370 employees and handled 5.2 million payments, but that those payments amounted to only about 9 percent of all of its bill payments and that the offices wouldn't be missed by customers.[38] "Customers' alternatives to conducting business in local (utility) offices are comparable, and in many cases better, in serving customers needs than the local offices."[39]

But PG&E wasn't just trying to benefit its customers. It was also trying to save money. Bill payments handled by company employees in company offices cost on average nearly six times as much as comparable transactions done at a payment location operated by a third party, PG&E said.[40]

> *"Maintaining a walk-in payment center is expensive and time-consuming. By outsourcing … you can provide this key service at a fraction of the cost of an in-house solution." CheckFree Corp. sales pitch to utilities.*[41]

PG&E spends $40 million annually handling in-person bill payments in a network that besides its 84 company-operated and staffed front counters includes 431 third party pay stations – including 71 operated by licensed payday lenders.[42]

PG&E estimated that it would save $24 million annually by shutting down its offices and promised to pass those savings on to customers. However, those savings

[37] PG&E 2007 General Rate Case Phase 1, PG&E Exhibit 5, workpapers p. 6AB-173 to p. 6AB-176 (2005 Local Office and Pay Station Survey by Hiner & Partners Inc.).
[38] Pacific Gas and Electric Co. 2007 General Rate Case, Phase 1, Exhibit PG&E-05: Chapter 6: Local Office and Pay Station Operations, p. 6-5.
[39] Ibid, p. 6-3.
[40] Ibid.
[41] CheckFree web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46390.
[42] List of PG&E neighborhood payment stations provided by the Utility Reform Network., on file with author.

if realized would amount to only two-tenths of a penny on each of the company's more than 10 billion dollars in annual operating expenses.

And, according to consumer advocates, the burden of achieving those savings would not be shared equitably among all of PG&E's customers. "The primary beneficiaries of PG&E's payment centers are underserved communities," John Gamboa of the Greenlining Institute, a consumer advocacy organization that opposed PG&E's bid to shutter its service centers, said in a filing with state regulators. Those who would suffer from the shutdowns would include minorities, new immigrants, the elderly and low-income communities, he said.[43]

Faced with opposition from consumer advocates and from rural communities, PG&E trimmed its plan to close offices and in April agreed to keep open all but nine of its least-used offices. However, the company's filings made it clear that it intends to seek permission to close more offices in the future.

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[43] Testimony of John C. Gamboa on behalf of the Greenlining Institute on PG&E's Workforce Diversity, Supplier Diversity, Philanthropy, Payment Centers and Energy Efforts, p.12, , filed April 28, 2006 in PG&E's 2007 General Rate Case Phase I.

V. MARRIAGE OF CONVENIENCE: PAYDAY LENDERS SEEK CUSTOMERS

Payday lenders collect payments of utility bills in order to bring through the door potential customers for their ultra-high-cost and very profitable loan products. Payday lenders aim their marketing efforts at utility customers because there are millions of them. And those who pay bills in person – low-income, minority, female, elderly, all characteristics sought by payday lenders – make ideal targets. In fact, payday lenders so covet the traffic generated by bill payment that they often introduce the services without making deals with utilities.

So why are payday lenders so often willing to take over the job of processing thousands or even millions of utility bills? Because it's good for business – their business.

Or, as CheckFree tells prospective bill payment agents, collecting payments "offers the opportunity to turn a bill payer into a loyal customer."[44]

Utility walk-in customers make especially good prospects for payday lenders, check cashers and other high-cost lenders. Expansion of the market for high cost financial services has been fueled by population growth and "declining to stagnant growth in household income of lower- and middle-income people," payday lender ACE Cash Express said recently.[45] The company described its primary market as "the nation's approximately 60 million unbanked and underbanked individuals." Minorities comprise about half its clientele, who are generally renters, have average

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[44] CheckFree web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46389&contentId=46435&menuId=46441. That's not news to the utilities. Third-party operators "typically agree to be a pay station to generate additional 'foot traffic' into their establishments, as well as to obtain extra revenue from the transaction fee paid by PG&E for each bill payment," PG&E said. (Pacific Gas and Electric Co. 2007 General Rate Case, Phase 1, Exhibit PG&E-05: Chapter 6, p. 6-6).

[45] ACE Cash Express, Form 10K, Aug. 29, 2006, p.4.

annual incomes of about $30,000, and typically "pay bills with walk-in payments or money orders." The profile of payday loan customers is "skewed towards older females."[46]

That's a profile that corresponds to the demographics of utility customers who pay their bills in person. PG&E found in a study of its walk-in bill payers that about two-third were females, about three-quarters were over 35 years old and more than half were renters.[47]

For retailers slow to make the connection, CheckFree has a pitch ready. "You have the stores. You want more customers. We have the solutions."[48] CheckFree says it acts as an intermediary between 11,000 third-party bill payment collection sites and 150 billers, including 50 utility companies, who farm out collection services.[49] "Walk-in Bill Payment Services offers retail locations an easy and inexpensive way to generate foot traffic, retain more customers and grow your business," the web site adds. "In fact, it costs you nothing and it even pays you a commission."[50]

CheckFree, a company 10 percent owned by software giant Microsoft Corp.[51] handles PG&E's bill payment outsourcing.[52] CheckFree posted 2006 revenue of $879 million, recently had a market capitalization above $3 billion[53] and includes on its board the former chairman of Visa International and former high-ranking executives

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[46] ACE Cash Express, Form 10K, Aug. 29, 2006, p. 9.
[47] PG&E 2007 General Rate Case Phase 1, PG&E Exhibit 5, workpapers p. 6AB-173 to p. 6AB-176 (2005 Local Office and Pay station Survey by Hiner & Partners Inc.).
[48] CheckFreePay web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46437&menuId=46441.
[49] CheckFreePay web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46393.
[50] CheckFreePay web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46437&menuId=46441.
[51] CheckFree Corp. Form 14A filed with U.S. Securities and Exchange Commission, Sept. 26, 2006, p. 13.
[52] Pacific Gas and Electric Co. 2007 General Rate Case, Phase 1, Exhibit PG&E-05: Chapter 6, p. 6-6, footnote 8.
[53] CheckFree Corp. Form 10K filed with U.S. Securities and Exchange Commission, Sept. 8, 2006, p.26.

of Bank of America and State Street Research.[54] CheckFree also lists Progress Energy, Southern California Edison, AT&T, BellSouth and Verizon as customers for its outsourced bill payment services.[55]

Other payday lenders and third parties interject themselves into the bill payment transaction without any formal arrangement with a utility. These unauthorized agents get in the game by advertising their services, and cover their costs by collecting fees from customers.

CheckFree also has a piece of the "unauthorized" agent action. In fact, its web site features a pitch for retail locations that want to get into the bill collection game without waiting around for a utility deal. Going the "unauthorized" route avoids the sometimes burdensome rules and obligations that come as part of the baggage of entering into relationships with regulated utilities, CheckFree says: "Because (non-contracted bill payment service) is regulated by CheckFreePay and not the utility companies, you have an opportunity to earn a greater profit on each transaction."[56]

A payday lender or check casher acting as an unauthorized bill payment agent collects an average transaction fee of $1.29 from the customer, according to a recent survey of check cashing and payday loan establishments by the Consumer Federation of America.[57]

However, some agents have more aggressively embraced the "opportunity to earn a greater profit on each transaction." The CFA survey found one check casher in the state of Washington where the fee for payment of an electric bill ranged from

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[54] CheckFree Corp. Form 14A, Sept.26, 2006, p. 5-6.
[55] CheckFreePay web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46393.
[56] CheckFree web site at www.checkfreepay.com/cda/checkfreepay/L2.jsp?layoutId=46439&menuId=46441
[57] Cashed Out, p.7.

$6.95 to $8.95 and another where the fee for a transaction was an eye-popping $12.95.[58]

Yet a fee isn't the biggest problem that a utility customer may encounter when paying a bill at a payday lender. Each transaction has the potential to introduce that customer to a seller anxious to entice them into a high-cost, short-term loan that could easily fester into a long-term debt.

Using payday lenders or check cashers as bill payment agents can't be justified as a response to consumer preferences, according to a 2005 PG&E customer survey. Four out of five customers in the study said they would like to see pay stations located in grocery stores. One out of five said they would like to have a chance to pay bills in drug stores. But only 7 percent of those surveyed asked for bill payment in check cashing outlets.[59]

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[58] Cashed Out, Appendix C

[59] PG&E 2007 General Rate Case Phase 1, PG&E Exhibit 5, workpapers p. 6AB-171, (2005 Local Office and Pay station Survey by Hiner & Partners Inc.)

VI. WHAT SHOULD BE DONE

Preventing victimization of consumers requires highlighting the potential for predatory lending created by utility bill payment at a payday lender. It requires holding utilities accountable for allowing or encouraging bill payment at payday lenders. It requires that state utility regulators prohibit dangerous bill payment practices and include in utility rate bases funding for safe bill payment options and services that take into account consumer preferences. It requires that state and federal financial regulators discourage and, where possible, prohibit use of bill payment as a marketing tool by ultra-high-cost lenders.

For more than half a decade Alabama Arise Citizens Policy Project, a coalition of religious and community groups that advocates on behalf of low-income people, has fought in the Legislature and in the courts to stop the spread of payday lending. So when the coalition discovered that half of the 45 third-party payment stations affiliated with Alagasco, the local natural gas utility, were payday lenders or other provides of high-cost financial services, Alabama Arise spoke up.

At an Aug. 31, 2006 meeting that Alabama Arise analyst Ron Gilbert described as "heated," low-income advocates urged Alagasco to stop directing customers to payday loan stores to pay bills. Company officials argued that it needed payday lenders to serve customers in remote areas. But eventually the company relented, and agreed to ask the administrator of its third-party payment stations to eliminate payday lenders from its network where possible and to only keep payday lenders in areas where no other retail outlets could be found.

"We had engaged a third party to do third-party bill payment services for our customers," said Anne Powers, Alagasco's director of customer relations. When locations other than payday lenders were found to collect bill payments, she added, the payday lenders "were dropped."

Gilbert credits the company for having met its commitment. A recent tally by Alabama Arise found that only two of Alagasco's 61 third party payment stations were high-cost lenders.

Other utilities should follow Alagasco's lead. Utilities should recognize that contracts with payday lenders to serve as bill payment agents pose a threat to consumers. Payday loans could trap them in debt, and jeopardize their ability to pay for the necessities of life – including utility services. Payment arrangements with payday lenders should be dropped by utilities and prohibited by regulators. Instead, utility bill payment centers should be located throughout utility service territories in company-owned and operated facilities, government offices, community centers or retail establishments – such as supermarkets, banks and drug stores – not geared to marketing ultra-high-interest loans.

A federal law passed in 2006 recognized the threat posed by predatory lenders and put a ceiling on interest rates charged to military personnel and their families. Utilities and state regulators should learn from that example, and stop contracting with payday lenders to act as bill collection agents.

The unholy marriage between utilities and payday lenders can't be justified as a measure to lower retail rates. Certainly, as consumer advocates we support responsible efforts to keep utility rates at the lowest possible levels. But cutting costs by eliminating safe and convenient payment collection locations makes no sense – especially when it directs vulnerable customers to businesses that specialize in ultra-high-cost or predatory loans. Spread throughout a utility's customer base, the costs of providing safe bill payment locations will have a negligible impact on utility rates.

Recommendations

1. State regulators should prohibit utilities or their agents from entering into arrangements to pay for bill collection services from financial service companies or other lenders that lend money at exorbitant rates (typically, an annual percentage rate above 36 percent).

2. State regulators should require utilities to maintain company operated and staffed service centers, including counters for in-person bill payments using cash, at locations convenient for customers throughout utility service territories.

3. Regulators should allow utilities to sign contracts for bill payment services at additional locations that enhance convenience for customers but only with supermarkets, drug stores, convenience stores, other retail outlets, community groups and banks or other financial service providers that do not lend money at exorbitant rates.

4. Regulators should require utilities to verify the eligibility of all retail service providers to act as bill payment agents. Utilities should be required to verify that all authorized or unauthorized bill payment agents from whom utilities accept payment do not hold licenses that allow them to lend money at exorbitant rates.

5. When utilities accept payments from third parties that offer bill payment services to customers but have no contracts with utilities, regulators should require utilities to receive from those agents certifications that they have charged customers no more than a nominal amount (typically, $1 or 1 percent of the amount due, whichever is lower) for bill payment, and that those customers have not been solicited to take out loans.

6. Utilities should only be allowed to close down company operated and staffed service centers if they can demonstrate that the cost of those centers would put an unreasonable burden on ratepayers.
7. State and federal laws and financial services regulations should prohibit lenders who collect utility bill payments from promoting or soliciting lending services before, during or after the transaction, and from lending money at exorbitant rates for use in utility bill payments.

Appendix

Payday lending may be unfamiliar to most American consumers but it's no secret to Wall Street. Six companies that operate more than 100 payday loan stores list their stocks on major exchanges, and one was listed until its recent purchase by a private ownership group. Regulatory filings by the listed companies show that each has at least one credit line, or readily available loan, arranged by some of America's largest banks.

PAYDAY LENDERS WITH STOCKS LISTED ON MAJOR EXCHANGES	Shares Listed on	Payday Loan Stores	Annual Revenue ($million)	Annual Profit ($million)	Credit Line(s) ($million)	Lead Banker(s)
Advance America Cash Advance Centers Inc.	New York Stock Exchange	2,853	$551.4	$70.2	$265	Bank of America Corp., Wachovia Corp., Wells Fargo & Co.
ACE Cash Express Inc.	No longer listed. JLL Partners, a private equity group, bought the company in 2006	1,241	$309.9	$25.0	$275	Wells Fargo & Co.
QC Holdings Inc.	Nasdaq	613	$172.3	$9.2	$45	U.S. Bancorp
Dollar Financial Group Inc.	Nasdaq	345	$328.5	$ 7.0	$80	Wells Fargo & Co.
EZCorp Inc.	Nasdaq	296	$315.9	$ 29.3	$40	Wells Fargo & Co.
Cash America International Inc.	New York Stock Exchange	295	$693.2	$ 60.9	$250	Wells Fargo & Co. and JPMorgan Chase & Co.
First Cash Financial Services Inc.	Nasdaq	145	$269.7	$ 31.7	$50	JPMorgan Chase & Co. and Wells Fargo & Co.

Note: Information reported in company's most recent Form 10K filed with U.S. Securities and Exchange Commission. Revenue and profit also include pawn shops, check cashing and other operations. Credit line information compiled from Form 10Ks and other SEC filings and exhibits.

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