

SUBJECT: Licensing requirements for new and relocated pawnshops

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Averitt, Denny, Ehrhardt, Elkins, Marchant, Pitts, Juan Solis
0 nays
2 absent — Solomons, Grusendorf

WITNESSES: For — Robert Ekstrand and Mary Jackson, Cash America International; W.J. Mike Murphy, Texas Association of Pawn Brokers
Against — Tom Anson, James J. Dean, Vincent A. Lambiase, EZCorp Inc.; Rob Schneider, Consumers Union
On — Leslie L. Pettijohn, Office of Consumer Credit Commissioner

BACKGROUND: The Texas Pawnshop Act, codified as Finance Code, chapter 371, delegates regulatory authority over pawnshops to the commissioner of consumer credit.

Pawnbrokers are licensed annually. A pawnbroker’s license may be renewed automatically, so long as the pawnbroker remains in the place of business indicated on the license or moves less than one mile from the current location. The commissioner’s approval is required for a pawnshop to move more than one mile away from its current location.

New pawnshops require a new license, which also requires the commissioner’s approval. In counties with a population below 250,000, the commissioner must approve licenses for all eligible applicants. Finance Code, sec. 371.052 states that applicants are eligible for licenses if they are of good moral character, meet net asset requirements (see below), demonstrate that they will operate their businesses lawfully, and demonstrate the financial responsibility, experience, character, and fitness to operate a pawnshop.

In 1991, the Legislature enacted the “show need” system to check the growth of pawnshops in counties with a population exceeding 250,000 (Harris, Dallas, Bexar, Tarrant, El Paso, Travis, Hidalgo, Nueces, Denton, Collin, and

Cameron). Under the “show need” requirements, the commissioner may issue a license only if:

- ! the applicant is eligible under Finance Code, sec. 371.052;
- ! there is a public need for the pawnshop; and
- ! the volume of business in the community where the pawnshop will operate indicates probable profitability.

The “public need” and “probable profitability” standards — also known as “show need” — apply both to new entrants into the county and to relocations of existing pawnshops. Current law requires license holders to notify the commissioner of their intentions to relocate their pawnshops into or within these larger counties 60 days before their intended move date. The law does not prohibit pawnbrokers from moving next door to existing pawnshops so long as the “show need” standards are met.

On request, the commissioner must hold a public meeting before granting or denying a license to an applicant. All pawnbrokers who would be affected by the granting of a license can appear at the meeting and present evidence to support or oppose the application.

Pawnbrokers must maintain net assets of at least \$150,000. Because older pawn licenses were grandfathered with respect to net asset rules, some pawnbrokers are required to maintain less than \$150,000 in net assets, depending on when the license was issued first. If a pawnbroker relocates, the requirement is 5 percent above the total outstanding loans and the value of the inventory on the relocation date, not to exceed \$150,000. The net asset requirements do not apply to a change in ownership involving a family member or substantial business partner, a change in the proportionate ownership of existing owners, or a change in ownership resulting from testate or intestate disposition.

Current law requires a pawnbroker to replace pledged goods that are lost or damaged while in the pawnbroker’s possession with like merchandise. The replacement is subject to the approval of the commissioner. There is no requirement that a dissatisfied pledgor pursue the commissioner’s decision that a pawnbroker’s replacement offer is insufficient before taking the pawnbroker to court.

The annual license fee for pawnbrokers is \$100. The commissioner may reinstate an expired license but may not charge an additional fee. Current law requires pawnshop employees to apply for a license not later than the 30th day after they begin employment. The annual employee license fee is \$10.

DIGEST:

CSHB 1878 would replace the existing “show need” standards with a system based on minimum distance between the applicant’s intended location and existing pawnshops. The bill would increase license fees for pawnbrokers and employees and would establish a reinstatement fee for expired licenses. The bill would require pledgors to exhaust administrative remedies through the commission before taking a pawnbroker to court over a dispute involving lost or damaged merchandise. It also would amend net asset requirements.

Distance requirements. CSHB 1878 would replace the current “show need” standards with a system based on the distance between the new or relocated pawnshop and any existing pawnshops. For applications in counties with a population of 250,000 or more, the commissioner could not approve:

- ! a new license for a proposed location within two miles of an existing licensed pawnshop, unless the proposed location already was an existing licensed pawnshop;
- ! a relocation of a pawnshop to a proposed location within one mile of an existing licensed pawnshop, unless the proposed location already was an existing licensed pawnshop; and
- ! a relocation of a pawnshop that has not been in its current location for more than three years to a proposed location that is further than one mile from its current location and closer than one mile to an existing licensed pawnshop.

The commissioner nonetheless could approve an application for a pawnshop that had operated less than three years in its current location to move to a new location if the relocation were caused by circumstances outside the applicant’s control. The commissioner also could approve a relocation of a pawnshop to a location marginally farther than one mile away from its current location but within one mile of another existing licensed pawnshop. Distance would be measured from front door to front door. These distance requirements would be applicable only in counties with a population exceeding 250,000. A pawnbroker wishing to relocate would have to apply to the commissioner at least 30 days before the intended move date.

Administrative remedy. The bill would require pledgors who were dissatisfied with a pawnbroker's offer to replace lost or damaged goods to exhaust administrative remedies through the Office of the Consumer Credit Commissioner before seeking a remedy in court. The bill would amend the Finance Code to indicate that a purpose of the Texas Pawnshop Act is to "prevent overburdening of court dockets by providing an administrative procedure for the handling of disputes over lost or damaged goods."

Net asset requirements. The bill would amend the Finance Code provisions for the minimum net assets required for a license. The bill would retain the \$150,000 minimum for new licenses but would require existing licenses granted before September 1, 1999, to maintain at least the amount required on August 31, 1999. It would stipulate that net asset requirements remain in effect without regard to any change in ownership.

License fees. CSHB 2320 would increase the pawnbroker's annual license fee to \$125 from \$100 and would increase the pawnshop employee's annual license fee to \$25 from \$10. The bill would increase the time new employees have to apply for a pawnshop employee license to 75 days after employment commences.

The bill would create a new procedure for reinstating expired pawnbroker licenses. The commissioner would have to reinstate an expired license if, within 180 days of the expiration date, the pawnbroker paid the delinquent \$125 annual fee and a \$1,000 reinstatement fee. The commissioner would have to send notice of pawnbrokers' reinstatement rights promptly by certified mail when their annual fees become delinquent.

CSHB 1878 would take effect September 1, 1999, and would apply only to applications for new licenses or relocations filed on or after that date.

**SUPPORTERS
SAY:**

CSHB 1878 would address communities' concerns about the proliferation of pawnshops by requiring that new licenses and relocated pawnshops be a specified distance from other pawnshops.

Local communities justifiably are concerned about the concentration of pawnshops, particularly in lower-income, higher-crime neighborhoods. For these communities, more pawnshops do not reflect the kind of development

that they want. Though the “show need” requirements have succeeded partially in slowing the growth of the pawn industry in these communities, they have not succeeded in addressing the problems of clustering. Communities remain concerned that too many pawnshops present an unwelcoming image as they try to attract new development and businesses.

Local governments have the authority to regulate most businesses that affect the community’s sense of itself through zoning and land-use ordinances. These regulations have survived court challenges because of the compelling public interest in regulating these businesses. Communities do not have this authority with respect to pawnshops. State law grants sole authority to regulate pawnshops to the Legislature, which has delegated specific responsibilities to the commissioner.

The current “show need” system in use for larger cities is subjective, time-consuming, and expensive. Protested hearings can take more than a year to conclude and can cost more than \$20,000 per party. Protests usually are waged by larger companies that can afford to hire lawyers and economists to participate in the hearings. Small business owners typically are shut out of these proceedings because of the expense and time involved. Because of the expense associated with a contested “show need” application in larger counties, many pawnshop owners have moved their stores to just outside these counties, causing a ring of pawnshops around a large city.

CSHB 1878 would provide more certainty that a pawnbroker license would be issued because there would be a simple and easily understandable set of objective criteria that, once met, would require the granting of a license. It would reduce greatly the number of contested license cases, allowing pawnbrokers to begin serving customers immediately. It would provide predictability and remove the subjectivity inherent in the “show need” hearing process. There still would be some protested hearings, particularly over some relocation circumstances, but these would be fewer and farther between than under the current “show need” hearings.

The fact that a pawnshop is not located next to another pawnshop does not mean the shops are not competitors or that customers are not being served. The distance requirements in CSHB 1878 would encourage pawnbrokers to do market research to find potential customers who are not being served now, rather than join a crowded field in a particular location. A more even

distribution of pawnshops would ensure that all people who need pawn services had reasonable access to a local pawnshop. The financial services provided by pawnshops are not duplicated by banks and other lending institutions. Customers are hurt if several pawnshops attempting to operate within the same customer base end up going out of business.

The bill would not affect adversely the abilities of pawnbrokers to move their businesses. Two miles typically corresponds to the market served by a pawnshop. The commissioner has denied several new license applications because of a concern that there were already enough pawnshops in the area. This bill would codify several rules of thumb used by the commissioner to determine whether a pawnshop should be allowed to locate in a particular community. It would enable active licensees to move their businesses within a mile of their current locations if they had been in their current places of business for three years. Shops that had been in their present location for less than three years still could obtain the commissioner's approval to move. The distance requirements would provide a rational framework for relocating businesses to where customers' needs are not being met without having to go through a "show need" hearing.

The distance requirements would not be anticompetitive. CSHB 1878 would not bar entry into a market and would not discourage competition between pawnshops. There are already 1,400 pawnshops in Texas and another 200 inactive licenses. The bill would encourage the upgrading of current businesses and the reactivation of inactive licenses. It also would allow a rational expansion of the industry as the state's suburban areas expand.

Recent appeals court rulings conflict over a pledgor's remedy with respect to disputes over lost or damaged goods. One ruling gave pledgors a choice in remedies, while another stipulated that an administrative remedy must be pursued before going to court. This bill expressly would provide an administrative remedy that must be pursued before going to court. Too many of these disputes go to court now, choking local court dockets, instead of appealing to the commissioner's existing authority to approve pawnbrokers' replacement offers. Most of the time, the problem is solved by a letter from the commissioner, meaning that these cases never have a hearing, whether before the commissioner or a judge.

CSHB 1878 would encourage pawnbrokers to keep their licenses current by assessing a \$1,000 reinstatement fee if the license is allowed to expire.

OPPONENTS
SAY:

The state has no rational interest in restricting the ability of legitimate businesses to locate or relocate where their potential customers are. The territorial restrictions envisioned in CSHB 1878 effectively would preserve the monopoly power of existing pawnshops by banishing their competition to the outskirts of town. The proposed system of licensing pawnshops would violate the Texas Constitution, art. I, sec. 26, which forbids monopolies as “contrary to the genius of a free government.” Should the law be thrown out because of a court challenge, the commissioner could lose any authority to regulate the locations of pawnshops until new legislation was passed.

Consumers always are hurt when the state gives them fewer choices than the market otherwise would allow. This bill is inconsistent with the market-based philosophies of a state that is looking to deregulate electric power generation and further deregulate telephone and cable utilities.

Competitiveness is subjective from any regulatory standpoint. The “show need” standard may not be the most efficient way to determine the location of pawnshops, but it is a fair way. All interested parties have the opportunity to be heard, and the commissioner has the latitude to judge an application on the basis of community needs. “Show need” also could involve preventing new pawnshops if the community believes enough exist already.

CSHB 1878 would not reduce protested hearings. Expert witnesses, economists, and attorneys still would be needed to argue for and against applications as issues involving “marginally more than one mile,” “circumstances beyond the applicant’s control,” and “needs to relocate” are resolved. These issues ultimately will rest upon an applicant’s ability to show need for a relocation and the ability of opposing interests to demonstrate that the standard is not met.

The distance requirements proposed in CSHB 1878 do not take into account population density, which determines the customer base and the potential for competition. The “show need” standard has served well enough to justify its continuation, specifically because it allows the commissioner to evaluate the potential competitiveness of new entrants to the market.

This bill would favor companies who acquire existing businesses over entrepreneurs who attempt to start new businesses. Under the bill's distance requirements, the only way to enter a market would be to buy an existing business or take over an inactive license. The bill would be a windfall for existing businesses, which would see their value at least quadruple.

Existing pawnshops also could be hurt by these distance requirements, especially those that have been in their current locations for less than three years. The bill would restrict their ability to move and could put them at a disadvantage when negotiating with third parties such as landlords. Pawnbrokers needing to move for business reasons would have a high burden of proof to overcome if their applications were contested.

The need for services provided by pawnshops will not decline if there are fewer pawnshops or if they are more spread out. Banks and other financial institutions do not provide these services. Competition between pawnshops is not a negative consequence of urban development, as it has been portrayed. It is simply the result of competitive forces in the marketplace, which is why many car dealerships, service stations, banks, and shopping areas are located near one another.

The threat of immediate litigation in a local court encourages pawnbrokers to treat their customers in a reasonable manner. CSHB 1878 would make it harder for customers to resolve disputes with a pawnbroker over pledged goods that were lost or damaged. Forcing a pledgor to exhaust all administrative remedies would give the pawnbroker a substantial negotiating advantage in handling a dispute with a pledgor. Since the exhaustion of administrative remedies is not time-limited, it could be months before the dispute was resolved. If the dispute rose to an administrative hearing, it would be available only in Austin. Also, the requirement to exhaust administrative remedies would increase the number of cases brought before the commissioner, creating a potential need for additional appropriations to handle the workload. The bill's fiscal note does not account for this increased workload.

OTHER
OPPONENTS
SAY:

The distance requirements ought to be extended to all Texas counties. Pawnshops have sprung up all across Texas, particularly in suburban counties surrounding the "show need" counties. Limiting the distance requirements to

the larger urban counties would force more pawnbrokers into surrounding counties.

The bill should clarify whether inactive licenses issued before 1991 and still listed at the same premises have any additional rights over inactive licenses issued since then with respect to relocations. Inactive licenses are not expired licenses. An inactive license is paid annually, but the licensee is not engaged actively in pawn activities. These licensees may have right, title, and interest to their present location without regard to its proximity to other licensed pawnshops.

The Texas Pawnshop Act should not include the reduction of court cases as an express purpose of the act, especially when the principal purpose of this bill — preventing the clustering of pawnshops — would be left out of the listed purposes.

NOTES:

The committee substitute would apply the distance standard only to counties with a population of 250,000 or more, not to all counties as in the original bill. The substitute added the phrase “needs to relocate marginally further than one mile” to the provision concerning the commissioner’s approval of a relocation for a pawnshop not in its place of business for at least three years. The substitute also would require all pawnshop owners to apply for a relocation 30 days before their intended move date. The original bill would have required 60 days’ notice for pawnshops that had not been in their current location for at least three years.

The substitute added new sections to increase the annual pawnbroker license fee to \$125 and the annual pawnshop employee license fee to \$15. The substitute would require a pawnshop employee to apply for a license within 75 days of employment, rather than within 90 days as in the original. The substitute increased the reinstatement fee to \$1,000 from \$900. The substitute also would require a pledgor to exhaust administrative remedies before seeking remedy in court for lost or damaged goods, whereas the original bill made the administrative remedy the sole and exclusive remedy available to the pledgor.

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The companion bill, SB 1813 by Harris, has been referred to the Senate Economic Development Committee.