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Banking, Commerce and Insurance Committee  
January 23, 2018

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[LB742 LB750 LB904]

The Committee on Banking, Commerce and Insurance met at 1:30 p.m. on Tuesday, January 23, 2018, in Room 1507 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB742, LB750, and LB904. Senators present: Brett Lindstrom, Chairperson; Matt Williams, Vice Chairperson; Roy Baker; Tom Brewer; Burke Harr; Mark Kolterman; John McCollister; and Paul Schumacher. Senators absent: None.

SENATOR LINDSTROM: All right, it's 1:30 so we'll get started here in the Banking Committee. Welcome to the Banking, Commerce, and Insurance Committee. My name is Brett Lindstrom, I'm from Omaha; I represent District 18. I serve as Chair of this committee. The committee will take up the bills in the order posted. Our hearing today is your public part of the legislative process. This is your opportunity to express your position on the proposed legislation before us today. The committee members will come and go during the hearing; we have to introduce bills in other committees and are called away. It is not an indication we're not interested in the bills being heard in this committee, just part of the process. To better facilitate today's proceedings, I ask that you abide by the following procedures. The information is posted on the chart to your left. Please silence or turn off your cell phones. Move to the front row when you are ready to testify. The order of testimony will go introducer, proponents, opponents, neutral, and closing. Testifiers please sign in; hand your pink sign-in sheets to the committee clerk when you come up to testify. Spell your name for the record before you testify. We ask that you please be concise; it is my request that you limit your testimony to five minutes. If you will not be testifying at the microphone but want to go on record as having a position on a bill being heard today, there are white tablets at each entrance where you may leave your name and other pertinent information. These sign-in sheets will become exhibits in the permanent record at the end of today's hearing. Written materials may be distributed to committee members as exhibits only while testimony is being offered; hand them to the page for distribution to the committee and staff when you come up to testify. We will need ten copies. If you have written testimony, but do not have ten copies, please raise your hand now so the page can make copies for you. To my immediate right is committee counsel, Bill Marienau; and to my far left at the end of the table is committee clerk, Jan Foster. And we will start with introductions of the senators starting on my far right.

SENATOR SCHUMACHER: Paul Schumacher, District 22; that's Platte and parts of Colfax and Stanton Counties.

SENATOR BREWER: Tom Brewer, District 43; 13 counties of western Nebraska.

SENATOR WILLIAMS: Matt Williams, Legislative District 36; Dawson, Custer, and the north part of Buffalo Counties.

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SENATOR HARR: Burke Harr, Legislative District 8, representing parts of Douglas County.

SENATOR LINDSTROM: And Senator McCollister and Senator Baker and Senator Kolterman are all introducing bills in other committees right now, so they probably will join us when they're finished up in the other committees. Our pages today, we have a new page, so welcome. It's Cadet Fowler from Lincoln, Nebraska; and Alyssa Lund from Woodbury, Minnesota. We will, like I said, the committee will take up the bills in the order posted. I do have the first bill with LB742, so I will turn the committee over to Vice Chairman Williams. [LB742]

SENATOR WILLIAMS: Thank you, Chairman Lindstrom. And we will open the public hearing on LB742 and invite Chairman Lindstrom to make his opening statement. [LB742]

SENATOR LINDSTROM: Thank you, Senator Williams. My name is Brett Lindstrom, L-i-n-d-s-t-r-o-m, representing District 18 in northwest Omaha. LB742--in the 2016 session, the Legislature enacted LB942 introduced by Senator Scheer, to amend the Nebraska Franchise Practices Act to give Nebraska arbitrators and courts specific authority to reform and enforce the terms of a noncompete agreement between a franchisor and a franchisee if it is found to be unreasonable. The change placed Nebraska in line with almost every other state which recognizes the authority to reform agreements rather than voiding the entire agreement. This bill was supported by franchisee and franchisor alike. While the Franchise Practices Act clearly applies to all franchisees based in Nebraska, the act limits application to reform and enforce noncompete agreements when both the franchisee and franchisor are located in Nebraska. LB742 clarifies that the original intent of the reform provisions in current law will also apply when a franchisor is headquartered in Nebraska and enters into a noncompete agreement with an out-of-state franchisee, unless the parties agree otherwise. When agreed, Nebraska arbiters or courts would have the specific authority to reform the noncompete agreement to make it reasonable. There will be witnesses behind me who can give you greater detail on this bill. I'd be glad to answer any questions you have. Thank you. [LB742]

SENATOR WILLIAMS: Questions for Senator Lindstrom? Seeing none, thank you for your testimony. We will invite the first person to testify in favor of this legislation to the stand. Welcome, Mr. Otto. [LB742]

JIM OTTO: Thank you, Senator Williams, members of the committee. My name is Jim Otto, that's J-i-m O-t-t-o; I'm a registered lobbyist for the Nebraska Retail Federation and the Nebraska Restaurant Association. I'm testifying in support of LB742 on behalf of both. The franchise model is an excellent economic development tool. Valentino's, Runza, Hobby Town, Eileen's Colossal Cookies, these are just a few examples of Nebraska-based restaurant and retail franchisors that have applied that franchise tool to hundreds of franchisees in other states. They

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and other Nebraska franchisors continue to expand outside of Nebraska and bring dollars for the franchises they sell and a percentage of the business that each location does back to the state of Nebraska. It is important to note that noncompete clauses protect both the franchisor and the franchisee by providing certainty to both parties. It is a two-way street that benefits both. As Senator Lindstrom explained, LB742 fulfills the intent of prior legislation by extending the protection from unfair competition that noncompete clauses provide to franchisees outside of Nebraska. Present statute limits that protection to franchisees within Nebraska. This is an opportunity to make a large impact with a small technical change. We urge the committee to move LB742 to General File. I'm glad to answer any questions, and thank you. [LB742]

SENATOR WILLIAMS: Questions for Mr. Otto? Senator Harr. [LB742]

SENATOR HARR: Thank you, Senator Williams. Are you representing the franchisor or the franchisee? [LB742]

JIM OTTO: Both. We have members that are franchisees and we have members that are franchisors. [LB742]

SENATOR HARR: Okay. Because the franchise...that relationship is kind of a love-hate relationship. And so when you met, both sides agreed that this is good law? And then my follow-up...and that's a yes. [LB742]

JIM OTTO: Yes. Sorry. [LB742]

SENATOR HARR: Okay. And then follow-up question is...turn your phone to mute please...how does state law control if it's between two states, wouldn't it be federal law that would control that area? [LB742]

JIM OTTO: Well, we're talking about the...you're an attorney, Senator, I'm not an attorney, but we're talking about the franchise agreement...let's say Hobby Town which has over a hundred franchise outside of Nebraska...franchisees outside of Nebraska, Lincoln-based franchisor, that agreement, the way I understand it, could not...if the Supreme Court of the United States...or the court, excuse me, the Supreme Court of Nebraska could not just fix the noncompete clause and make it reasonable. They would throw out the entire franchise agreement if we did not do that. [LB742]

SENATOR HARR: And my legal experience is limited to (inaudible) law, and I had a noncompete and I got to remember this, but because one of the parties was from outside the

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state, they said, hey, it's federal law and therefore it's federal noncompete law that applies, not the state. And I'm not quite sure on that. I could do more research on that or refresh my memory, but are you aware of anything to that degree? [LB742]

JIM OTTO: I am not, Senator. But I think someone testifying behind me will be able to clarify that for you. [LB742]

SENATOR HARR: Okay. Thank you. [LB742]

SENATOR WILLIAMS: Okay. Additional questions for Mr. Otto? Senator Schumacher. [LB742]

SENATOR SCHUMACHER: Thank you, Senator Williams. Thank you, Mr. Otto, for testifying. The new language says: notwithstanding Section 87-403, this subsection will apply. What, do you know offhand what 87-403 is? [LB742]

JIM OTTO: I don't, Senator. Once again, the testifier behind me may. [LB742]

SENATOR SCHUMACHER: Okay. Thank you. [LB742]

SENATOR WILLIAMS: Additional questions? Seeing none, thank you, Mr. Otto. Next proponent? Welcome. If you'd please state your name and spell it for us. [LB742]

MATT BOEVER: (Exhibit 1) Sure. Good afternoon, Vice Chair Williams and members of the Banking Committee. My name is Matt Boever, and that's M-a-t-t, and the last name is B-o-e-v-e-r, and I'm at Home Instead Senior Care in Omaha, but here on behalf of the International Franchise Association, or IFA; the State Chamber, and the Greater Omaha Chamber of Commerce, and happy to support this. I think for both franchisors...well, Senator Harr asked about International Franchise Association, or IFA, it represents both franchisors and franchisees, so it's both. I'd have to check on...I'd be pretty sure that both chambers, the Greater Omaha and the State Chamber would have franchisee representation as well. Home Instead is a member of both of those. But we see this as a good thing, as Senator Lindstrom and Jim mentioned, it provides some clarity for the franchisor and the franchisee in these noncompete situations. It just applies to noncompetes in the franchise context. So the franchisor would appreciate that ability to enter into that relationship with franchisee sharing sort of that secret sauce of franchising. And then the existing franchisees, after a franchisee will leave the system, the remaining franchisees would appreciate for a reasonable period of time and for a reasonable space not having to compete with that former franchisee who, for whatever reason is, you know, no longer part of the

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franchise network. You asked about federal and state law. I'm not aware of any federal law that would trump or that would take place of state laws. There are...most states have franchise relationship laws. Nebraska is one of those, the Nebraska Franchise Practice Act dictates the...sort of the rights and duties of franchisors and franchisees. Other states would have it as well. It's possible you get into sort of a conflict of law analysis, but I guess for the purposes of these franchise agreements, these would be franchise agreements based on Nebraska law where like Home Instead is a franchisor based in Omaha with about 600 or so franchises in the 50 states. And that agreement and that noncompete that's...part of that agreement would be governed by Nebraska law. So if that's helpful context. But I'd be happy to answer any questions. [LB742]

SENATOR WILLIAMS: Questions for Mr. Boever? Senator Harr. [LB742]

SENATOR HARR: Thank you. Thanks for coming, Matt; good to have you back. Nebraska is a right to work state, is that correct? [LB742]

MATT BOEVER: Yes. [LB742]

SENATOR HARR: Okay. Noncompete clauses scare me. I believe we want people in this state to work. Why do we give franchise the ability to contract out of noncompetes that we don't give anyone else the ability to do? [LB742]

MATT BOEVER: I guess I'd answer that on a...with a couple of points. The courts look at it, this is dealing strictly with franchising; it doesn't deal with the employer, employee, or even the general sale of business context, this would just be strictly franchisor and franchisee agreement. So in that case, you don't have the...with an employer/employee you've got, obviously, and courts rightly so, scrutinize those contracts or covenants not to compete or...differently than they would a sale of business or a franchise because there the employee, obviously, has a...their livelihood and the hardship in that situation and the bargaining power between those two parties is different. [LB742]

SENATOR HARR: Is what? [LB742]

MATT BOEVER: Is different. When typically courts scrutinize those noncompetes and the employer/employee...you know, it's...the employee is told here's the agreement, you know, they don't have the same kind of negotiating power as there would be in the franchise context. And I guess one more point is that in the franchise context, those agreements are often for a lot longer...for a long term, so at Home Instead, for example, it's a 10-year contract. [LB742]

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SENATOR HARR: And so that's a 10-year noncompete? Or how long is it...how long are your, in your contracts, noncompete after the contract is over? [LB742]

MATT BOEVER: One year. [LB742]

SENATOR HARR: Okay. And what have the courts ruled, generally, is a reasonable period for a noncompete? [LB742]

MATT BOEVER: It's a really fact-specific analysis, and the opinions, and I'm not a franchise law expert by any means, but of the opinions that I've read, you know, one year in one instance might not be enough. Five years, you know, might be...I mean, you know, one year might be too much in one instance and five years might be well within reason in another just because it is so fact specific in the kind of information, good will, trade secrets, that is protected. [LB742]

SENATOR HARR: So when are these enforceable? When is a noncompete...let's say you take away my franchisee right for whatever reason, is it a matter of the reason you take it away as the period, you're saying it's fact specific. What goes into determining how long a noncompete period is? [LB742]

MATT BOEVER: That's spelled out in the franchise agreement. [LB742]

SENATOR HARR: Okay. So you're... [LB742]

MATT BOEVER: I was asking kind of when it starts. [LB742]

SENATOR HARR: What's it in your contract? [LB742]

MATT BOEVER: One year. [LB742]

SENATOR HARR: It's what? [LB742]

MATT BOEVER: One year. [LB742]

SENATOR HARR: Always one year? [LB742]

MATT BOEVER: Yes. [LB742]

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SENATOR HARR: Okay. Would you be okay if we said reasonableness shall be limited to one year? [LB742]

MATT BOEVER: Well, I think because of the...I mean, the Nebraska cases that I've read, because it is so fact specific in franchising...Jim mentioned restaurants, I mean, but includes home care, it includes auto care, it includes personal...there's a lot of tech, so there's just a...I would be reluctant to say what's reasonable in one instance and... [LB742]

SENATOR HARR: I'm just always a little leery at keeping people out of the work force. I want people in Nebraska to work. And I want them to work in their highest best wage possible. And I understand if they're receiving something of value from the franchisee or franchisor, they may be...there is a period of time, but I also want to be able to determine what is that reasonableness period so that we can get people back in the work force, back paying taxes, off the public dole. [LB742]

MATT BOEVER: Yeah, I think this would just be for a short period of time and in a particular geography that this person...this former franchisee couldn't be in a competing business. So if, for example, I think it's analogise to a sale of business situation where you'd want as a buyer of business to know that the seller isn't going to turn around and directly compete with you. And it would be the same for a franchise. [LB742]

SENATOR HARR: Okay. Thank you. [LB742]

SENATOR WILLIAMS: Senator Schumacher. [LB742]

SENATOR SCHUMACHER: Thank you, Senator Williams. And thank you for your testimony today. Can you give me an example where the law, without this change, has created a problem. What are we fixing here? [LB742]

MATT BOEVER: Nebraska is one of a...I think it's...well, before the change two years ago, was one of three states that didn't allow the courts this authority to blue pencil or modify a noncompete to make it reasonable and enforceable. So it was an all or nothing approach. And following that legislation, currently that 87-403...that provides that the Nebraska Franchise Practices Act applies to any franchisee that's based in Nebraska. So this bill would also say that if a franchisor is headquartered here, that part of the authority in the Franchise Practices Act for the court to modify if a term is unreasonable and enforce the reasonable contract would also apply for a franchisor that's based here. So if a franchisor is based in Nebraska, franchisee in Ohio, for whatever reason they decided not to renew the franchise or...you know, did something

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to...that franchise was revoked, then the court...if it became an issue as to the noncompete, the reasonableness there, the court could modify and enforce it. So it's already in effect for all franchisees based in Nebraska; this bill would clarify that it would also apply under Nebraska law for any franchisor headquartered here. [LB742]

SENATOR SCHUMACHER: Well, the existing law...committee counsel handed me a copy of this Section 403: applies only to a franchise (1) the performance of which contemplates or requires the franchisee to establish or maintain a place of business in Nebraska, (2) have gross sales between the franchisor and the franchisee covered by the franchise shall then more than \$35,000 for 12 months; and when more than 20 percent of the franchisee's gross sales are intended to be or derived from such franchise. So we expressly said that this only applied to somebody who...to a franchisee who had a place in Nebraska. And now we're saying regardless of where they have a place, Nebraska law is going to apply to a noncompete agreement unless otherwise agreed by the franchisor and franchisee. Well what are we accomplishing? They can agree to go do anywhere. They can agree to have Delaware law apply is what you're saying. [LB742]

MATT BOEVER: Well, this would be in a situation where the franchisor is headquartered here. This bill would add that language...LB742 would add that as well, not to 403 but... [LB742]

SENATOR SCHUMACHER: This is notwithstanding 403, so regardless of what we said elsewhere about the size of the franchise and where the business is and the gross sales of \$35,000, all those things that were important at one time to us we're setting aside here and says regardless of where it is, a noncompete agreement can be rewritten, essentially, by the court. That's what we're saying. So if there's a franchisee in Ohio, a Nebraska court, regardless of how the rest of the contract would be interpreted or whether it falls under our law or not, the noncompete clause of it would fall under Nebraska law. [LB742]

MATT BOEVER: If the franchisor is headquartered in Nebraska. [LB742]

SENATOR SCHUMACHER: Yeah. But that wouldn't...but the rest of the agreement might not fall under Nebraska law if it was under \$35,000 or didn't meet these other requirements. So we have an agreement part of which is under Nebraska law and part of which might not be? [LB742]

MATT BOEVER: Oh, as far as...so...as far as talking about subsection (2) and (3) in 403 if the franchisee didn't meet those requirements? [LB742]



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SENATOR SCHUMACHER: Right. See then we'd be in...our law wouldn't apply because this only applies to those that meet the three requirements; so some other state law might apply. But as to these restrictions that are found to be unreasonable, restraining competition, the Nebraska part of it, so we would have a contract, maybe being reformed or rewritten, part under Nebraska law and part under some other law? [LB742]

MATT BOEVER: I don't...and this...I'm quickly out of my depth when it comes to a conflict of law analysis. Most states have their own franchise practices act similar to Nebraska. So if we're dealing with an out-of-state franchisee in Ohio, they would have certain rights and responsibilities under their state franchise practices act. And that's regardless of whether or not the contract would be, you know, would say that it's Nebraska law or not. I mean, the state will...you know, wherever that court is will...it doesn't necessarily...it's not a foregone conclusion that Nebraska law would apply. There's an analysis that has to take place. [LB742]

SENATOR SCHUMACHER: So I finish up my original question, can you give us an example of where...what has gone wrong? Do we have a case where Nebraska tried to reform a contract with somebody in Hawaii and somebody lost a lot of money? I mean, why are we here on this? [LB742]

MATT BOEVER: Oh, I think it creates a lot of certainty for the franchise community to know that a contract between a franchisor based in Nebraska and a franchisee that's out of state, that the court would have the authority to reform an unreasonable contract. Because it allows them some stability in owning that...that business to know that they're not going to be facing unfair competition from a former franchisee. That's why... [LB742]

SENATOR SCHUMACHER: If it's certainty in the franchise, then why don't we...why do we still keep these other requirements for everything else but this? [LB742]

MATT BOEVER: Well, I think it's a...saying why not open the Nebraska Franchise Practices Act up to wider spread application among its... [LB742]

SENATOR SCHUMACHER: I mean, if this is a good idea, for certainty, if that's the reason, then we have...we don't apply the rest of our act to it unless it meets these three steps. I just...as a practical matter, you know, if you'd say, look it, XYZ franchise had this big lawsuit in Ohio because it tried to impose Nebraska law or reformed the contract and they argued that it was Ohio law and it created a big mess and this is why we need to be more particular, then I could see why we're fixing this. But I still don't know why we're fixing this. [LB742]

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MATT BOEVER: Sure, yeah, I guess I can't give you an example of something that's...but I...it's, I guess, from the franchising community it's possible to put, kind of, two and two together that it would be possible to create a headache for the existing franchisees in the network and the franchisor based in Nebraska. [LB742]

SENATOR SCHUMACHER: Thank you. [LB742]

SENATOR WILLIAMS: Senator Harr. [LB742]

SENATOR HARR: Thank you, Senator Williams. I guess I'm still confused as to the purpose of this law. So, currently franchisor-Nebraska; franchisee-Ohio; the noncompete is found unreasonable. The whole contract is voided and therefore I'm able to go back to work doing whatever the heck I want that is limited by the franchise agreement. Noncompete now is found, let's say we pass this bill, and they say, okay, you know what, that noncompete was unreasonable. The franchise agreement is in effect. What does that do to me as a franchisee? I'm not sure what happens. Am I not allowed to work, because then you're enforcing the noncompete, or is it that they have to pay a civil penalty for going into a unreasonable...I'm not sure what your, as a franchisor, remedy is if the noncompete, because I think that's the remedy for violating a franchise agreement. What's your remedy then? Okay, I violate the noncompete. Excuse me, you violate, you made nonreasonable noncompete, what am I limited as a franchisee that I can't do? [LB742]

MATT BOEVER: So are you still a franchisee? [LB742]

SENATOR HARR: I don't know...well, it says here, you know, that the franchise agreement...right now as I understand it, it's noncompete I franchisee violated...excuse me, I challenge...I challenge to say the noncompete is unreasonable; courts say, yep, you're right, that franchise agreement doesn't apply and I'm able to go out and do my trade...apply my trade. Now with this law, court says, you know what, that noncompete is unreasonable. What am I the franchisee allowed to do or prohibited from doing as a result of this law because there's a franchise agreement that's still in effect, is that right? That's what this bill does...or what does it do then? [LB742]

MATT BOEVER: I don't think so. I think if you're a former franchisee, then the franchise agreement...I mean the... [LB742]

SENATOR HARR: So what does this bill do? [LB742]

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MATT BOEVER: So it would, in your example, it would...if...you're saying the franchise...the noncompete portion of the...so the noncompete is part of the franchise agreement. [LB742]

SENATOR HARR: Correct. [LB742]

MATT BOEVER: So that would, I guess, last a little bit longer than so...let's say you decided to move on to another business or open another business, do something else, so it's post-franchise agreement or post... [LB742]

SENATOR HARR: Okay. [LB742]

MATT BOEVER: There would be...every franchise has a noncompete that you don't enter into a competing business within a certain period of time and for a particular geography. So this would allow the court there in Ohio, or another jurisdiction to look to Nebraska law and reform the contract to make it reasonable. So if, say 45 miles outside of that territory is found to be unreasonable, the court could say it's 20 miles. [LB742]

SENATOR HARR: So is the purpose of this bill to say whatever Nebraska's noncompete policy is...or law is the noncompete that applies for that franchise as opposed to...California has a very liberal right-to-work state, right? They hate noncompetes in California. Is the idea that...and by the way, we are a right-to-work state. Ours is somewhat liberal as well, because we want people to work. Is the idea behind this bill then that we always apply Nebraska noncompete standards? [LB742]

MATT BOEVER: Yes. [LB742]

SENATOR HARR: Is that...at the end of the day, that's what it is, as opposed to your concern about am I applying Ohio and Ohio, California and California, Nebraska and Nebraska. You want it to be uniform Nebraska Nebraska. [LB742]

MATT BOEVER: Yes. I can envision a situation where you'd have a foreign court that has a franchise practices act...or has something in statute that says anything over a certain mile or time period is, per se, unreasonable, then...I mean the...again, I don't want to misdirect you, I mean there could be a situation like that where the court would say, well, we're applying this Ohio portion of the law, but we're looking to Nebraska law as to whether or not, you know, in other ways it's reasonable or there might be a specific statutory direction in that state, so I would say yes, but... [LB742]

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SENATOR HARR: Okay. Thank you. [LB742]

SENATOR WILLIAMS: Senator Schumacher. [LB742]

SENATOR SCHUMACHER: Thank you, Senator Williams. Thank you. Just one follow-up question. He mentioned certainty among this being a motive for not only this clause but the whole bill here...the statute that's already enforced. What I read this as saying, basically in Nebraska you enter into a franchise agreement with a noncompete clause at your peril because you don't know for sure if or what a court might find unreasonable. And if it does find something unreasonable can impose something you...completely different. And so you really don't know where the dice are going to stop rolling. All you know is if a court finds it unreasonable, you may be forced into an agreement you never even dreamt of. I mean, how is that certain to? [LB742]

MATT BOEVER: I guess I was talking about certainty that there would be some reasonable agreement enforced by the court. [LB742]

SENATOR SCHUMACHER: Well, is certitude good? And if so, while we have this section opened, is there anything we should do to make it more certain as far as what the outcome is going to be? I might...with this on the books, I might not want to either be a franchisor or franchisee for fear that I'm going to get in an argument with the other party and a court is going to ram something down our throat that neither one of us agreed to. [LB742]

MATT BOEVER: Yeah, I think...parties answering to the agreement, you know, and the court is allowed, in this instance, to...if it finds part of it unreasonable can change that. And the majority of courts, you know, all but a couple, allow the courts this authority in this context. [LB742]

SENATOR SCHUMACHER: Okay. Thank you. [LB742]

SENATOR WILLIAMS: Mr. Boever, but as opposed to that, under current law right now then, if we have a franchisor in Nebraska and the franchisee outside of the state, the court does not have that opportunity. All they can do is say it's either reasonable or the whole contract is void. And that's where the certainty comes. This isn't...let me try to put this in a form of a question. This doesn't have anything to do with whether we believe in noncompetes or whether we're right to work. It believes in creating more certainty for the two parties involved in a franchise agreement. Is that the case? [LB742]

MATT BOEVER: Yes. Yes. [LB742]

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SENATOR WILLIAMS: Any further questions for the witness? Seeing none, thank you for your testimony. [LB742]

MATT BOEVER: Thanks very much. [LB742]

SENATOR WILLIAMS: Next proponent? Seeing none, is there anyone here to testify in opposition? Anyone here to testify in a neutral capacity? Seeing none, would you like to close, Senator Lindstrom? [LB742]

SENATOR LINDSTROM: I don't know how much I have to add to the conversation with regard to this. Interesting questions brought up and I understand some of the, I guess, satellite discussions with regard to this, but I think Senator Williams your question with regard to whether or not that court would have authority to...or arbitrator to get in between or to settle an agreement...or disagreement between a franchisor and franchisee. It's just to make sure that we have that statute in law in Nebraska to give certainty to those franchisors based in Nebraska. I mean I think it's as simple as what the question was that you were directed in the other stuff. It doesn't necessarily apply to this particular bill, but with that I'd be happy to answer any final questions. [LB742]

SENATOR WILLIAMS: (Exhibit 2) Questions for the senator? Seeing none, Jan, we have a letter. We have a letter from Duane Thomas of Valentino's in your packet. Thank you, and that will close the hearing on LB742. [LB742]

SENATOR LINDSTROM: Okay, we'll now open the hearing on LB750, introduced by Senator Williams. Whenever you're ready, Senator Williams. [LB750]

SENATOR WILLIAMS: Thank you, Chairman Lindstrom, and fellow members of the Banking, Commerce and Insurance Committee. My name is Matt Williams, M-a-t-t W-i-l-l-i-a-m-s, and I'm the senator representing Legislative District 36. I bring before you today LB750 which is designed to streamline and clarify, first, the requirements for a lender to release a lien when the obligation secured by a mortgage or deed of trust has been satisfied and a written request for release has been received, and (b) the consequences to a lender for failing to timely release its lien following such a request. The bill also provides that transfer of any debt secured by a mortgage shall also operate as a transfer of a security of such debt, similar to existing provisions of law relating to trust deeds under Section 76-1016. I've introduced this bill on behalf of the Nebraska Bankers Association which expressed an interest in bringing greater uniformity to the provisions of law relating to the release of mortgages and reconveyance of trust deeds, as well as the statutory provisions authorizing third parties to release mortgages or reconvey trust deeds. Currently, multiple statutes affect this area of law with varying provisions regarding the manner

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in which liens are to be released and differing provisions regarding the damages that are applicable in the event the lender fails to timely release the lien. While there are substantive provisions contained within LB750, which I will address in a moment, the legislation primarily consists of a reshuffling of the deck of chairs to place all substantive provisions of law relating to the release of mortgages, reconveyances of trust deeds and damages for failure to timely release liens in a single statute, namely Section 76-2803. Under current law, Section 76-252 and 76-1014.01 require the release instrument to be delivered to the borrower for filing. This does not match with the universal practice of lenders recording the instrument with the register of deeds. Recording the release instrument rather than delivering it to the borrower for filing is more customer friendly by not burdening the borrower with the need to file the lien release. There have been cases in which a release instrument delivered to a borrower did not make its way to the courthouse for filing, potentially resulting in the delay for the borrower and requiring the lender to duplicate its efforts in providing or recording the release potentially exposing the lender to damages provided under these sections of law. Therefore, the primary substantive change under LB750 is to replace the obligation of the lender to deliver the release of mortgage or the deed of reconveyance to the borrower for filing with an obligation for the lender to record or cause to be recorded the release of mortgage or deed of reconveyance with the register of deeds. We have also clarified that the lender must also have received a written request to release the mortgage or to reconvey the trust deed. Additionally, Section 1 of the bill addresses the notion that the mortgage follows the note in connection with lending transactions. These provisions would bring the law relating to mortgages into conformity with the law relating to trust deeds, Section 76-1016 relating to trust deeds already provides that the transfer of any debt secured by a trust deed shall operate as a transfer of the security therefore. LB750 would simply extend these provisions to the transfer of any debt secured by a mortgage. I have submitted amendments for consideration by the committee which address a number of very technical issues brought to my attention following the introduction of the legislation. Bob Hallstrom of the Nebraska Bankers will follow me with testimony, will provide the committee with the description of the amendments. I would request the committee favorably consider LB750 and advance the bill and would be happy to answer any questions. [LB750]

SENATOR LINDSTROM: Thank you, Senator Williams. Any questions from the committee? Seeing none, thank you. We'll now move to proponents. [LB750]

ROBERT J. HALLSTROM: (Exhibits 1, 2 and 3) Chairman Lindstrom, members of the committee, my name is Robert J. Hallstrom, H-a-l-l-s-t-r-o-m, and I appear before you today as registered lobbyist for the Nebraska Bankers Association in support of LB750. Senator Williams has done a nice job of outlining for the committee the purposes underlying LB750. I'd just like to relate to the committee that this was an issue that was brought to our attention by a number of bank lawyers who had expressed some concern over the fact that there are varying provisions with regard to a series of three specific statutes that addressed the issue of release of liens,

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reconveyance of trust deeds, and the damages or consequences that are associated with the failure of a lender to timely release its lien. And as a result, when we look at those three statutes, 76-252 relating to mortgages, 76-1014.01 relating to trust deeds, and 76-2803 which was the most recently enacted statute in this area of the law which provides authority for a third party to release under certain circumstances a lien when the lender has failed to do so in a timely fashion. And when you look at the chart that is attached to my testimony, it provided a little bit of a pictorial, if you're more visual than text, you ought to kind of set forth the areas of the law in which there are varying provisions relating to the releases and the damages and so forth. So as you can see from those three statutes, they have a little bit different format with regard to what triggers the need to release, obviously, payment or satisfaction of the obligation in the case of one statute also a written request. We're providing uniformity in the form of LB750 by indicating that both of those criteria, in essence, the satisfaction of the obligation and the written request to release will apply now in the resulting statute which is 76-2803. I've also noted in my testimony that for the guide for practitioners, we have not completely repealed Section 76-252 or 76-1014.01, but used it as a bench post to guide them to 76-2803 for the rules of the road that will apply in the event that the legislation is adopted. With regard to the issue of damages--there are two standards for damages under current law. Under the deed of trust and mortgage statutes, the damages are the greater of \$5,000 or actual damages, and in addition, reasonable attorney fees and court costs. Those apply if the lender fails to timely release its lien. Under 76-2803, the damages are actual damages, plus reasonable attorney fees and court costs. We have kept that bifurcation of damages, if you will, under LB750 and they are predicated upon if the written request for release is made by an original party to the transaction. The higher standard of potential damages, the greater of \$5,000 or actual damages will apply if the written request for release is made by a party that was not an original party to the transaction. The actual damage is standard would apply. Senator Williams has indicated the primary substantive change that we're making is to change from the requirement of the lender to execute and deliver to the borrower the release instrument and replacing that with what is, I think, the universal practice to have that lender record the release instrument to ensure that it is done, done properly and to avoid being exposed to potential damages if it gets lost in the shuffle or in the transaction. The last part of the bill that we have, which is actually in Section 1, has to do with the common law concept of the mortgage follows the note since the Deed of Trust Act was adopted, I believe, back in the mid-1980s, we have had language relating to the mortgage following the note. We did a little research on this issue, found the law in Nebraska is favorable in terms of the mortgage following the note and also discovered that we did not have that specific statutory language with respect to mortgages, so we are adopting an amendment...or proposing an amendment to 76-238 to bring the language into consistency with that which applies to trust deeds. A little bit of a technical bill. I apologize for that, but I'd be happy to address any questions that the committee might have. [LB750]

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SENATOR LINDSTROM: Thank you, Mr. Hallstrom. Any questions from the committee?  
Senator Schumacher. [LB750]

SENATOR SCHUMACHER: Thank you, Senator Lindstrom. Thank you, Mr. Hallstrom.  
Senator Williams said to ask you the hard questions. [LB750]

ROBERT J. HALLSTROM: There may be a witness after me that you could ask. (Laughter) Go  
ahead. [LB750]

SENATOR SCHUMACHER: The mortgage following the note...okay, so somebody takes a note  
from the debtor and the debtor gives them a mortgage and that's recorded down at the register of  
deeds office. And you look and say, oh, ABC Bank holds the mortgage. ABC Bank turns around  
and signs the note to somebody else and then, basically, goes out of business. The note is still  
good, note is paid off, I go down to the courthouse to check the record and I see ABC Bank  
holds the mortgage. I mean, it doesn't even have to be out of business, holds the mortgage. How  
do I know I...who has power to release that mortgage then? Who do I...and if ABC Bank isn't  
there, who do I chase down to release it? [LB750]

ROBERT J. HALLSTROM: Well, there's two different situations, Senator. This particular set of  
statutes in this bill is not going to affect the situation where there's nobody at the end of the  
phone because they've gone out of business. This is a situation where there may have been a  
transfer or an assignment of the promissory note and the security instrument which is we've  
provided here and under the trust deeds act currently automatically occurs that if the note is  
transferred, the security follows the note. What you're looking at is, you will generally have one  
of two situations in terms of today's market of securitization of loans; you may have a specific  
transfer or assignment interest of the mortgage that will appear of record to show who the second  
or third lender is to which that interest may have been transferred. Also in the securitization  
market you've got the MERS registry where MERS is established as the nominee initially for the  
original lender and subsequent assignments of that loan will appear in the MERS registry that  
can be accessed as well to find out who currently may hold that particular note and security.  
[LB750]

SENATOR SCHUMACHER: So you're basically kind of eliminating the need to file an  
assignment of mortgage or assignment of the deed of trust or something? [LB750]

ROBERT J. HALLSTROM: It can result in that...it can result in that. [LB750]



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SENATOR SCHUMACHER: Okay. And then the second question is, I don't know how many bankers actually run the release or have their secretary or staff run the release down to the register of deeds office to file it. Most often, I would guess, they file it through a title company. They go through a closing and they send a release over; when they get their check they say file it. [LB750]

ROBERT J. HALLSTROM: Correct. [LB750]

SENATOR SCHUMACHER: Is that what this is intended here? I mean, do we need to say anything more that...the holder of the mortgage or the deed of trust does it need to file it...delivery to a title company is sufficient? [LB750]

ROBERT J. HALLSTROM: Well, the language in the bill, Senator, says record or cause to be recorded. So I think that provides the flexibility. At the end of the day, the obligation is to get it recorded, have it filed of record so that the lien interest is released. But I think the language "record or cause to be recorded" should address the issue of if you've got an agent or a third party handling that for you. [LB750]

SENATOR SCHUMACHER: But if you give the release to the title company and for some reason it is not recorded, then it was not recorded and not caused to be recorded. And yet I would think that the banks would want to say, hey, this is a title company's problem because we gave them a release. [LB750]

ROBERT J. HALLSTROM: Well, and it would probably work out that way as a practical matter once that situation was determined in virtually every case. The simple solution is to get a new release...deed of reconveyance to file in the absence of that being lost or misplaced in some fashion in the transition. [LB750]

SENATOR SCHUMACHER: Well, on the other side of the transaction, I want my \$5,000 or whatever. [LB750]

ROBERT J. HALLSTROM: Well, that's why delivering it to the borrower causes that same potential-type of scenario if they don't file it you're putting it into somebody's hands that argue that because they might not have as much knowledge of the system, may not get it done as likely as the title agent would. [LB750]

SENATOR SCHUMACHER: Thank you. [LB750]

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ROBERT J. HALLSTROM: And, Senator, I would like to note also, I've submitted testimony from Camille Hawk with Valentine O'Toole, who is one of the attorneys that had contacted us initially to request that we consider these types of statutory changes. The other issue is with regard to the amendments that I've presented to the committee, they basically are technical in nature. What they do provide for, however, is clarification that the request for release and the notices that are required to be given to a lender in terms of terminating a line of credit or ceasing the extension of optional future advances are required to be provided in writing. So we've provided that uniformity and consistency throughout the bill as well with these amendments. [LB750]

SENATOR LINDSTROM: Very good. Seeing no other questions, thank you, Mr. Hallstrom. [LB750]

ROBERT J. HALLSTROM: Thank you. [LB750]

SENATOR LINDSTROM: Other proponents? Seeing none, any opponents? Also seeing none, any neutral testifiers? Seeing none, Senator Williams, would you like to close? [LB750]

SENATOR WILLIAMS: Thank you, Chairman Lindstrom. And again, the primary substantive change is to change the filing. You think about the fact that right now the law requires that as an obligation and duty of the borrower. Think about your own situation with your own home loan, the last thing you would want to do is when it's paid off that you are responsible for that activity. And this shifts that to the lender. And, yes, Senator Schumacher, there could be a difference with the title company, but I think it's still "file or cause to be filed" and I think you could make that the obligation of the title company. I would encourage the committee to adopt the amendment and advance the bill. If there are any questions, I'd be happy to try to answer them. [LB750]

SENATOR LINDSTROM: Thank you, Senator Williams. Any final questions for the senator? Seeing none, thank you, Senator Williams. And that will close the hearing on LB750. We will now move to LB904. Senator Vargas, welcome to the BCI Committee. [LB750]

SENATOR VARGAS: Thank you very much, Chairman Lindstrom, members of the committee. Thanks for having me back. [LB904]

SENATOR LINDSTROM: Glad to have you. [LB904]

SENATOR VARGAS: Good afternoon, everyone. My name is Tony Vargas, T-o-n-y V-a-r-g-a-s, and I represent District 7 and the communities of downtown and south Omaha in the Nebraska

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Legislature. LB904 closes a loophole that exists in current law that would allow payday lenders to skirt regulation and obtain a new license as a credit services organization or CSO. CSOs are defined in Nebraska statute as organizations that exist to help improve a consumer's credit rating. Currently, there are fewer than 10 licensed CSOs that provide these services to Nebraskans. The intent of the statute is good. Unfortunately, what has happened in other states is that as a result of pending regulation by the federal Consumer Financial Protection Bureau, payday lenders have tried to skirt regulation by obtaining a CSO license which allows them to act as a broker and charge larger fees to borrowers to arrange loans for other lenders including payday loans. Now this practice significantly increases the cost of taking out what is already a high-cost loan. In states with regulatory conditions similar to Nebraska where payday loan interest rates can be more than 460 percent, the addition of a brokerage fee charged by this new CSO to obtain the loan can make the cost of a loan more than 300 percent higher. That equates to a loan cost that's more than 700 percent of the principle amount in many cases. Now LB904 would ensure that payday lenders could not participate in this abusive lending practice by preventing the CSO from charging any brokerage fee in connection with the payday loan, it's very specific. Nebraska CSO statutes were never intended to govern short-term, high-cost loans like payday loans which is why they're not currently operating in that way. And this is a perfect indication that payday lenders should never be allowed to relicense as CSOs. Just for your information, CSOs are regulated by the Secretary of State's Office, while payday loans are rightfully under the purview of the Department of Banking. In conversation with the Secretary of State, they have commented that CSOs are fairly quiet license application for them and they have no interest in regulating or licensing payday lenders. I think actually right now we have a list of eight CSOs that are currently licensed. LB904 is the bare minimum of where we as a state should be doing to protect consumers and prevent businesses from manipulating a loophole in current law. Nebraska already needs reform in the payday lending industry, we can't afford to exacerbate it by not taking this preventative measure. With that I'll be happy to take any questions. [LB904]

SENATOR LINDSTROM: Thank you, Senator Vargas. Any questions from the committee?  
Senator Schumacher. [LB904]

SENATOR SCHUMACHER: Thank you, Senator Lindstrom; thank you, Senator Vargas. The statement of intent says it closes a loophole in current law that would allow payday lenders to relicense as CSOs. And I think I've got the right copy of the bill, the only underlined language I can see in it is...says: notwithstanding any other provision of law, charge any brokerage fee or any other fees whatsoever in connection with a loan governed by the Nebraska Installment Loan Act. It says nothing about licensing or CSOs or anything else. It's just that they cannot charge a fee with something governed under the installment act. Arguably, if they were licensed as a CSO and it wasn't under the Installment Loan Act, that the loan wasn't, they could charge a fee. I mean, I don't see the language in the bill mirroring what's in the statement of intent. [LB904]

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SENATOR VARGAS: So let's say this is...so what's your question? [LB904]

SENATOR SCHUMACHER: My question is... [LB904]

SENATOR VARGAS: I'll make sure to answer your question. [LB904]

SENATOR SCHUMACHER: Does this prevent a payday lender from licensing as a CSO? And if so, where in the bill does it say that? [LB904]

SENATOR VARGAS: So what we've seen in other states is that as a result of reform that's happening in the current statute, and this one the delayed deposit...the one that we talked about for payday loans that they've moved to the Nebraska Installment Loan Act and have started operating like installment loans. In doing that, then they apply under CSO to get that license. So we're really trying to be precautionary because we are one of...well actually the only state in the Midwest that has this loophole still open. Most others don't even have the CSO statute on the books or have...are not permissive in the way that their CSO statute is written that would allow a payday lender to even apply. And so we're trying to get ahead of the game because a payday lender, unlike the list of eight other organizations, isn't about trying to improve your credit, like these other ones are. And by doing that, we're trying to be preventative. And so this is...if they move over to Nebraska Installment Loan Act, then they wouldn't be able to then charge this brokerage fee in addition on top of any other interest fees and things that they have, while this is any other fees in addition. We're trying to be proactive. That's the reason why. [LB904]

SENATOR SCHUMACHER: So the payday loan is not a loan under the Nebraska Installment Loan Act, is that...? [LB904]

SENATOR VARGAS: No it is not. It's currently under the separate act. [LB904]

SENATOR SCHUMACHER: So we're basically saying here if you're a payday lender, doing payday lender type things, you cannot also have another door on your office that says lender Nebraska Installment Loan Act? Why should they not be able to do business like anybody else can? Why should they be eliminated from doing business just because they're a payday lender? [LB904]

SENATOR VARGAS: Oh, no, they should be...so if they're operating under the Nebraska Installment Loan Act, great. We just don't want them, as a result of being under the Nebraska Installment Loan Act and then applying for this CSO and operating as if they are...this specific agency. It wasn't what the original intent was. [LB904]

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SENATOR SCHUMACHER: So this is a credit service organization...can charge a fee, and get (inaudible) with a loan under the installment act. [LB904]

SENATOR VARGAS: Um-hum. [LB904]

SENATOR SCHUMACHER: What does that have to do with payday lending? [LB904]

SENATOR VARGAS: It doesn't. The Credit Repair Organization Act that was passed by Congress in 1996 specifically enabled CSO to exist across the country. What it did was in response to proliferation of credit repair scams. That's why CSO was originally created. The act was intended to protect the public from unfair and deceptive advertising and business practices by credit repair organizations. However, CSO in certain states has been written differently in some ways and this isn't...we're just trying to be proactive because this isn't something that has been utilized. That's why we keep referring to it as a loophole because what we're seeing in other states is once we are...let's say we are reforming this product and it moves to Nebraska Installment Loan Act and then they apply under CSO, they can then add additional fees on. But that wasn't the intent of the CSO act when it was originally created. So, again, to our knowledge, none of these eight organizations are operating in this way. This really doesn't affect anybody that's currently a licensed CSO. This is just being proactive. We're not saying they can't be in the Nebraska Installment Loan Act, we're just saying that they can't apply to be a CSO. [LB904]

SENATOR SCHUMACHER: Thank you. [LB904]

SENATOR VARGAS: You're welcome. [LB904]

SENATOR LINDSTROM: I guess I have one question. Why would anyone go that route? There's a bill that I'm aware of under the Installment Loan Act that caps the interest rate at 24 percent the first thousand, and 21 percent for the thousand after, so it would be that cap. And then any fees on top of that...if they were able to do that, would that be better for the consumer at the end of the day because of the interest rate cap? [LB904]

SENATOR VARGAS: Repeat your question. [LB904]

SENATOR LINDSTROM: Well, if they were allowed to do that, operate underneath the Installment Loan Act with the caps that we have in place, would the consumer not have a better situation at the end of the day because of those caps, or would they be able to, under the fees, there's no structure on how we would have a cap on fees necessarily, but just the interest rate they could charge a large amount on the fee portion of that. Does that...following that? [LB904]

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SENATOR VARGAS: And I'll try to reclarify this--we're not regulating or changing the Nebraska Installment Loan Act, right, that's not touching this. What we're saying is that under the CSO, this act that defines CSO, that...we don't want a payday lender to use this in the way that it was never intended the CSO act. So we're not even touching the Nebraska installment act because that's not what we're touching. We're just touching the CSO act which is credit repair service. [LB904]

SENATOR LINDSTROM: Sure. I guess I was just asking a question...if it would even make sense for them to do so because of some of the limitation. [LB904]

SENATOR VARGAS: I think like anything, it would depend on the terms of whatever the regulation or form is within the act itself. [LB904]

SENATOR LINDSTROM: Sure. [LB904]

SENATOR VARGAS: And the intent of this is looking at the CSO, looking at the people that are currently licensed, looking at historically what we're seeing in other states, and the trend and evolution of what's been happening a payday lender...it (inaudible) reforms the industry and then as a result goes and then becomes a CSO because there's a loophole in some states and then they can recoup some of what they lost in some of the changes in the statute, whatever happened in their state to payday loans, and then be able to then recoup some fees operating as a CSO. And again, the CSO was originally created to...in response to proliferation of credit repair scams, it's intended to help build credit. And that's what the other eight organizations that are licensed, they are operating underneath that part of the CSO. So we're just touching that part. [LB904]

SENATOR LINDSTROM: So hypothetically, if you've got a restrictive state that outlawed it completely, this would be another avenue to go if...in business. [LB904]

SENATOR VARGAS: In terms...yeah, in terms of the number of states, we have data from 2010, the number of states that do not have CSO in statute or do not have this loophole in place, 50 percent of states have done that. And we are a small subset of states, specifically the only one in the Midwest that is permissive in its ability to then allow a payday lender to operate and be licensed as a CSO. [LB904]

SENATOR LINDSTROM: Okay. Senator Williams. [LB904]

SENATOR WILLIAMS: Thank you, Chairman Lindstrom. And thank you, Senator Vargas. A couple of questions I'm trying to get my mind around here. There have been instances where the

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banks in our state have thought about at least applying for a license under the Nebraska Installment Loan Act for various reasons. As you're aware, as members of this committee are aware, we had a rather interesting debate on the floor of the Legislature concerning the Nebraska Installment Loan Act and people on this committee changing how they voted out of committee and killing a bill on the floor of the Legislature. Are you aware of any legislation or any pending legislation that would restrict the ability of a payday lender to apply to receive a license under the Nebraska Installment Loan Act? [LB904]

SENATOR VARGAS: Of any legislation that would restrict a payday lender from becoming or applying to be...to operate under the Nebraska Installment Loan Act? I do not know of one off the top of my head right now. That's not what this is specifically doing. [LB904]

SENATOR WILLIAMS: Okay. Again, we have been a state that's tried to encourage business and growth there and I happen to be one that believes that there's a place for some of these organizations to participate if they're doing it the right way. So your purpose then is to limit a payday lender from being able to become registered or licensed as a CSO and taking a double, in essence, taking a fee. How are CSOs presently compensated in our state? [LB904]

SENATOR VARGAS: To my understanding that we have, again, eight registered CSOs, I can't talk to you about the structure, but these...they're trying to repair people's credit. So I can give you an example, people will, you know, (inaudible). [LB904]

SENATOR WILLIAMS: But you know how they are paid for their services? [LB904]

SENATOR VARGAS: Paid for their services...I do not know how they are paid for their services. And there will be people testifying after me that may be able to answer that question better. [LB904]

SENATOR WILLIAMS: Okay. I'll wait and ask them then. Thank you. [LB904]

SENATOR VARGAS: But I will say to your first question, we are not...we are not talking about the Nebraska Installment Loan Act. We are talking about the CSO act and this is to make sure that a payday lender would not be able to operate under the CSO act as it currently is because the CSO act was not designed to be that way and it hasn't been. And all we want to do is close a loophole just to be preventative and precautionary. We do this with...in other instances when we're just trying to be ahead of the game. [LB904]

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SENATOR WILLIAMS: But you are referencing the Nebraska Installment Loan Act in your legislation. [LB904]

SENATOR VARGAS: Yes. [LB904]

SENATOR WILLIAMS: Okay. Thank you. [LB904]

SENATOR LINDSTROM: Any other questions from the committee? Seeing none, thank you, Senator Vargas. [LB904]

SENATOR VARGAS: Thank you very much. [LB904]

SENATOR LINDSTROM: We'll now move to proponents of LB904. Good afternoon. [LB904]

KEN SMITH: (Exhibit 1) Good afternoon, Chairman Lindstrom and members of the committee. My name is Ken Smith, last name is S-m-i-t-h; I'm the staff attorney at Nebraska Appleseed. Nebraska Appleseed is a nonprofit law and policy organization that works for justice and opportunity for all Nebraskans. And I appreciate the opportunity today to testify in support of LB904. As Senator Vargas said, LB904 addresses the CSO loophole which is an unintended vulnerability that exists in Nebraska's current CSO act, the law intended to regulate entities that help improve consumer credit ratings. In other states, some payday lenders have exploited the CSO loophole to avoid state regulation of short-term lending. To exploit the loophole, a lender will relicense as a credit service organization. And in states that have permissive CSO statutes, such as Nebraska, CSOs have the ability to obtain an extension of credit for a buyer. Once licensed as a CSO, a lender can obtain a loan from a third party, extend the loan to a...broker the loan to a borrower and then charge a substantial brokerage fees in addition to interest on the loan. The result is the functional equivalent of a payday loan that evades interest rate limits and other consumer protections. So for example, in 2008, the state of Ohio imposed a 28 percent interest rate limit on payday loans under its Short-Term Loan Act. And to avoid this limitation, some Ohio payday lenders took advantage of the state's permissive CSO law, which is similar to Nebraska's, to make lump sum and longer term loans with extremely high interest rates. So an example that I saw, a lender in Ohio used the CSO loophole to extend a \$500 loan with an APR of 360 percent. So while there are no payday lenders that are currently utilizing the CSO loophole in Nebraska, but it is still important that we act now to close it and that's because the national trend in payday lending indicates that lenders are increasingly shifting towards making longer term loans, partly due to the recent federal rule on payday lending imposed by the CFPB that places new restrictions on short-term lending. So if the CSO loophole remains, lenders that are looking for alternative lending models would likely try to take advantage of it. So LB904 addresses this by prohibiting CSO licensees from charging brokerage fees, or any other fees, in



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connection with a loan governed by the Installment Loan Act. So this closes the loophole by removing the fee allowance that would incentivize lenders to seek licensure under the CSO statute. So, Senator Schumacher, it doesn't say in the writing like payday lenders may not apply for or be approved for a CSO license, but it entirely removes the fee structure or allowance that would incentivize a lender to do so in the first place. The Nebraska Legislature intended our credit services statute to regulate entities that help build consumer credit, not regulate short-term lending. As a result, the CSO statute doesn't include any of the consumer protections and interest rate and fee limitations that you can find in our Delayed Deposit Services Licensing Act or our Nebraska Installment Loan Act. So closing the CSO loophole is a commonsense policy change that would proactively protect Nebraska consumers. So we would urge the committee to advance LB904. And then if I could, just Senator Lindstrom, you asked about whether it would be a safer option because of the fee limitations under the Nebraska Installment Loan Act. And my understanding is the loan that is ultimately issued to the borrower, the now CSO collects interest on the loan, as well as a brokerage fee, that currently would be allowed for in statute and that fee wouldn't be part of the calculated interest for purposes of that loan. So installment loans do carry, obviously, that statutory interest rate cap, but this would allow the ceiling-less fee to be charged on top of that. And then, Senator Williams, I'm not sure of how CSOs are compensated. I know that if CSOs that are currently licensed are obtaining...brokering these types of deals and are charging fees for it and the way that they are compensated would be in any way affected by this bill, I know that we would be happy to work with them on ensuring that that's not the case. So that concludes my testimony and I'd be happy to answer other questions to the extent I'm able. [LB904]

SENATOR LINDSTROM: Thank you, Mr. Smith. Senator Schumacher. [LB904]

SENATOR SCHUMACHER: Thank you, Senator Lindstrom. Thank you for your testimony today. Can banks or, say, credit unions be CSOs? [LB904]

KEN SMITH: I imagine. An entity that wishes to help consumers repair credit could apply for the license. [LB904]

SENATOR SCHUMACHER: Or insurance companies that make loans? [LB904]

KEN SMITH: Perhaps not, I don't know. [LB904]

SENATOR SCHUMACHER: Okay, so not only are you catching payday lending, but you might be catching insurance companies, banks, credit unions, and everything else because this isn't limited to payday lending. This just says in connection with the...loan governed under the installment act. [LB904]

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KEN SMITH: Yeah, and as the senator testified, the Secretary of State has said this is a quiet licensing area. There are only eight licensees that exist now. And so it's not...with this only catches CSO licensees and only if they extend credit to a buyer...if they take up that statutory option. And then, even then, only if they charge fees related to that, and only then if it's governed under the Nebraska Installment Loan Act. [LB904]

SENATOR SCHUMACHER: So you're saying basically banks and credit unions don't make loans under the Nebraska Installment Loan Act. [LB904]

KEN SMITH: What I'm saying is banks and credit unions are not licensed under the Credit Services Organizations Act and so they would not be impacted by LB904. [LB904]

SENATOR SCHUMACHER: Thank you. [LB904]

SENATOR LINDSTROM: Any other questions? Senator Williams. [LB904]

SENATOR WILLIAMS: Thank you, Chairman Lindstrom. Thank you, Mr. Smith. In your testimony, you say while there are no payday lenders currently utilizing the CSO loophole in Nebraska, why aren't they currently utilizing that loophole? [LB904]

KEN SMITH: I guess I don't intend to speak for payday lenders, but at this point they seem to be... [LB904]

SENATOR WILLIAMS: Well, you're trying to close a loophole that they might have, so you're affecting them, so. [LB904]

KEN SMITH: Sure. I imagine they are running their business under the Delayed Deposit Services Licensing Act and are content doing that and have no need at this point in time to look for an alternative model. [LB904]

SENATOR WILLIAMS: Could I assume that it is because there's no incentive for them to do it today? [LB904]

KEN SMITH: You certainly could assume that. I would respond by saying... [LB904]

SENATOR WILLIAMS: I would assume that if it was to their benefit they would be doing it today. [LB904]

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KEN SMITH: As it stands today, yes. As I noted in my testimony,... [LB904]

SENATOR WILLIAMS: So are we trying to get ahead of the game here that there might be an attempt to change the payday lending laws in our state and have this loophole closed ahead of time so that if we take away their current situation and we've created an incentive for them to do this, we close that loophole first? [LB904]

KEN SMITH: We have seen for multiple different reasons that lenders are moving away from that very short term lending model. [LB904]

SENATOR WILLIAMS: And why is that? [LB904]

KEN SMITH: Well, there's research on...for example, it's borrowers' choice, so just market forces. Borrowers, I think would like, and research has shown, would like more time to pay off loans. Also, the CFPB, as I noted in my testimony, has already imposed a rule that affects any...or at least most loans that carry a 45-day duration or shorter. So there are already instances in which there's pressure for lenders to move into alternative business models. And because we have this permissive CSO statute, as lenders are looking to do that, if that happens in Nebraska in the future, this could be one loophole that they seek to operate through. And so we're just simply saying let's not let that happen. Payday lenders are not credit repair organizations. It has not ended well in other states. So let's just close that door before they walk through. [LB904]

SENATOR WILLIAMS: Thank you. [LB904]

SENATOR LINDSTROM: Thank you. Any other questions from the committee? Seeing none, thank you. [LB904]

KEN SMITH: Thank you. [LB904]

SENATOR LINDSTROM: We'll move to other proponents. Good afternoon. [LB904]

BUB WINDLE: Chairman Lindstrom, members of the committee, my name is Bub Windle, B-u-b W-i-n-d-l-e, here in support of LB904 on behalf of the Women's Fund of Omaha. Just hope to follow up on some of the questions asked. This bill is essentially about not letting payday lenders circumvent regulations. As Mr. Smith said, in Ohio they tried to pass some level of reform. What we saw there was the number of entities licensed as payday lenders dropped to zero and they just got licensed as CSOs. This is saying whatever we do with payday lending, and this isn't about what we do with payday lending, but let's keep it to payday lending and let's not let the lenders

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kind of snake over into the CSO statutes. Senator Schumacher, you asked why this talks about the installment loan act and not the payday lending act, the Delayed Deposit Services Act, which is the act under which payday lenders get licensed. It's because they dropped their license under the payday lending statutes if they're licensed as delayed deposit services licensee; they're regulated by that act. This references the Installment Loan Act because that's their other avenue, essentially, to broker loans as a broker. Senator Lindstrom, I think your question was answered about would the fees be better with installment loans. That 21 percent cap would still apply. What we've seen in Ohio is that the brokerage fee is so high that the cost of the loan is effectively 591 percent. So that cap applies, but then you've got that brokerage fee where they're really kind of hitting consumers hard. The brokerage fee can be hundreds of dollars on a hundreds of dollars loan. So it's a very large fee for a small dollar loan. And then Senator Williams, you kind of asked why aren't they doing this now. And I think it's because under current law, under our current payday lending laws, they're able to charge an effective APR 461 percent. That's one of the top ten most expensive rates in the nation. And so they don't need to operate as CSOs right now. They can make enough money at 461 percent loans under Nebraska law. And so like I said, this is about ensuring, as you all know, I mean there's a debate in front of this committee about what we should do with payday lending, whether that works, whether 461 percent loans makes sense for Nebraska consumers. The Women's Fund of Omaha would submit that doesn't make sense, but we're just saying that whatever we decide to do, whatever this committee and the Legislature decides to do with payday lending, those entities do not try to circumvent those regulations by simply getting licensed as another entity. With that I'll take any questions. [LB904]

SENATOR LINDSTROM: Thank you, Mr. Windle. Senator Schumacher. [LB904]

SENATOR SCHUMACHER: Thank you, Senator Lindstrom. Thank you for your testimony today. Well, let's just say we make a change to the delayed deposit act that the payday lenders use. And they say fine, you made a change, you made us make a different kind of loan or capped our interest rates or whatever the bill would do. So what we'll do is we'll live by those rules, but we'll go over there and we'll license ourselves also as a credit service organization. Under this bill, they could do that and maintain their high rates of interest, if that's what it is. I mean, you don't say...or any loan in connection with the delayed deposit act. [LB904]

BUB WINDLE: Yeah, that's right. So they could still make loans... [LB904]

SENATOR SCHUMACHER: So the loophole there, I mean, we say, whoa, payday lenders, you're ripping off people, or we're going to cap you some way or another. They say, fine, cap us, we'll just license ourselves here, we'll make the same money calling it a different thing. [LB904]

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BUB WINDLE: So you're saying they would be both... [LB904]

SENATOR SCHUMACHER: Yeah. [LB904]

BUB WINDLE: ...payday lenders and CSOs and charge a fee to brokerage loans to themselves? [LB904]

SENATOR SCHUMACHER: Right, I mean, why not, because we're not limiting that here. [LB904]

BUB WINDLE: I'd have to look back. I think the Delayed Deposit Services Act may prevent licensees from entering some of those other business lines, so it may be covered there. So you kind of can't have that two hat situation where you're brokering loans to yourself. But we can look into that for you. [LB904]

SENATOR SCHUMACHER: Because you're missing the mark if that's the case. [LB904]

BUB WINDLE: And if it's a concern that you think the bill should say, you know, you can't do a loan under the Installment Loan Act or the Delayed Deposit Services Act; I think we'd be happy to look at that language and make it broader to ensure that these entities aren't coming over and operating kind of under these other laws. [LB904]

SENATOR SCHUMACHER: Thank you. [LB904]

SENATOR LINDSTROM: Any other questions from the committee? Seeing none, thank you, Mr. Windle. [LB904]

BUB WINDLE: Thank you. [LB904]

SENATOR LINDSTROM: Other proponents? Seeing none, any opponents? [LB904]

KURT YOST: Chairman Lindstrom, members of the Banking, Commerce and Insurance Committee, my name is Kurt Yost, K-u-r-t Y-o-s-t. I'm a registered lobbyist for MM Finance, a payday lending corporation here in Nebraska and in Iowa. I'm also the registered lobbyist for Nebraska Financial Services Association, a trade group of the various payday lenders across the state of Nebraska. Originally, I was just going to sit back there and be quiet and say nothing about LB904. But I want to share with you that we...we're going to oppose LB904; we're not

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going to fall on our sword over LB904. But we do have concerns when it comes to the payday lending statutes. LB904, as Senator Vargas pointed out, and the young gentleman from Appleseed, these statutes are dealing with the credit service organizations. Quite frankly, I've had the good fortune to represent the financial industry for some-34 years before this body and I'd never heard of a credit service organization before. So it's something new to me. But I'm primarily here, Mr. Chairman, to be on the record on behalf of the payday lending industry and we don't want to spend, quite frankly, a lot of political capital on this piece of legislation. But so the record states we will oppose it. [LB904]

SENATOR LINDSTROM: Do we have any questions from the committee? Seeing none, thank you. [LB904]

KURT YOST: Thank you. [LB904]

SENATOR LINDSTROM: (Exhibits 2, 3, and 4) And we'll move to other...extend opposition, any other opponents? Seeing none, any neutral testifiers? Seeing none, I do have a couple of letters in support: Julia Tse from Voices for Children; Michelle Zych with Women's Fund (of Omaha); and Connie Benjamin with AARP of Nebraska. And with that, Senator Vargas, if you'd like to close. [LB904]

SENATOR VARGAS: Members of the committee, Chairman Lindstrom, I just want to thank you all for getting in this discussion and hearing everybody out. And I want to reiterate a couple of different points: one, we're talking about a CSO, the specific statute and trying to be as proactive as possible. I am going to look into making sure, and I think Mr. Windle mentioned this on whether or not on the Delayed Deposit Services Act that would you even be able to apply for a CSO. I believe what he said is that there's something that doesn't enable somebody to do that. We'll check into that. That's why it was originally written that way. There was a question about what banks or credit unions would be able to then apply under this. And they're part of the list of exemptions for the CSO as it currently exists; and that's in Statute 45-803. In terms of what we're talking about here, we're talking about credit CSO; we're talking about the credit services organizations as defined under our statute. We're trying to be proactive. Again, we're one of the permissive states, there are 25 states that have, for many different reasons, chosen to go down this route of changing the statutes and not being permissive. And we want to be a little bit ahead of the game, regardless of what the circumstances are. The CSO act was originally intended to then help repair people's credit. And that's what we're all...we're trying to keep the CSO to continue to do that. And I just want to thank all the members. And again, we're willing to work on this given that it's a little different and we're just being precautionous. Thank you very much. [LB904]

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SENATOR LINDSTROM: Thank you, Senator Vargas. Senator Schumacher. [LB904]

SENATOR SCHUMACHER: Thank you, Senator Lindstrom. So does this law prevent affiliates from holding these licenses? I mean, I might want to set up a thing called "Golden Girl CSO, LLC" and then the desk next to it have "Golden Girl Payday Loans, LLC" and the desk next to it have "Golden Girl Installment Loans, LLC"-- all different LLCs, good to go? [LB904]

SENATOR VARGAS: You mean to apply for a CSO? [LB904]

SENATOR SCHUMACHER: Yeah. [LB904]

SENATOR VARGAS: If you are trying to continue to add more fees on top of that and you're under the Nebraska Installment Loans Act and we pass this, then you would be unable to. [LB904]

SENATOR SCHUMACHER: The first desk isn't, though. The second desk is under the Installment Loan Act. Different LLCs, different desk, different...I might even put a different door in front of each desk. [LB904]

SENATOR VARGAS: So for the person that is the one that is applying for it, that's who would apply to. Again, that's my understanding. [LB904]

SENATOR SCHUMACHER: Okay, I can beat the system that way. So this should include affiliates. [LB904]

SENATOR VARGAS: Which is why we're willing to work with you, Senator Schumacher, to figure out ways that we, we can close the loophole on the loophole. [LB904]

SENATOR SCHUMACHER: Thank you. [LB904]

SENATOR VARGAS: Thank you very much. [LB904]

SENATOR LINDSTROM: I'm just more curious about the Golden Girls reference, but... (laughter) [LB904]

SENATOR VARGAS: I hope somebody won a bet. Anything else? [LB904]

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SENATOR LINDSTROM: Any other questions for Senator Vargas? Seeing none, thank you, Senator Vargas. [LB904]

SENATOR VARGAS: Thank you very much. [LB904]

SENATOR LINDSTROM: And that will close the hearing on LB904. Thank you all for coming today. [LB904]