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CONSUMER NEWS

By Jeremy LaMarche*

Payday Lenders Under Attack, Seek Protection in Cyberspace

Payday loan companies, who lure low-income consumers with fast-cash, are now looking to the Internet to avoid tightening state regulations.¹ Recent state efforts aimed at capping the normally exorbitant interest rates typically charged by short-term loan financial institutions have driven this turn to the Internet.² Recently, West Virginia Attorney General Darrell McGraw attempted to prohibit out-of-state financial companies from doing business via the Internet with West Virginia consumers.³ McGraw filed suit to enforce investigative subpoenas in connection with fourteen Internet financial lenders and “to enjoin their usurious lending activities in his state.”⁴

Payday loans are short-term loans usually intended to provide a financial bridge for low-income consumers from paycheck to paycheck.⁵ A borrower obtains a payday loan and in return writes the lender a check post-dated to the date of the borrower’s next payday.⁶ When the loan is due, the lender either deposits the check or debits the borrower’s account, or the borrower pays the lender the amount owed plus the interest accrued.⁷ When the borrower does not have

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¹ Huffman, Mark. *Payday Lenders Move Online, Try to Bypass State Laws*, Consumer Affairs, November 20, 2006, http://www.consumeraffairs.com/news04/2006/11/wv_payday_lenders.html.

² *Illinois Fines Payday Lenders \$500,000 in 10 Months*, Payday Loan Industry Watch, November 1, 2006, http://www.pliwatch.org/news_article_061101A.html.

³ Huffman, *supra* note 2 (noting that the State of West Virginia has a maximum allowable rate of 18 percent APR for consumer loans).

⁴ *Id.*

⁵ *Guidelines for Payday Lending*. FDIC, <http://www.fdic.gov/regulations/safety/payday/> (last visited December 8, 2006).

⁶ *Id.*

⁷ *Id.*

sufficient funds in her bank account to repay the payday loan and notifies the lender of this, the lender often will give the borrower the option to refinance the loan with a payment of an additional fee.⁸ If the lender attempts to deposit a check from the borrower and the check bounces, an additional charge will normally be added to the borrower's outstanding debt.⁹

The convenience of payday loans is often negatively outweighed by the high interest rates charged by the majority of financial lenders.¹⁰ Payday loans have short terms to maturity, and the annual percentage rate (APR) is usually very high.¹¹

When initiating a loan, many payday lenders do not perform an in-depth credit history analysis of the potential borrower.¹² Rather, many lending institutions merely want proof that the borrower is the recipient of a regular paycheck.¹³ As a result, many payday lenders have been accused of preying on low-income individuals and families who are in need of quick cash and willing to pay high-interest rates in order to obtain it.¹⁴

The combination of low-income borrowers, high interest rates, and deferred payment periods often leads to financial turmoil for many individuals choosing to take out a payday loan.¹⁵ Recently, the *Dan Rather Reports* ran a segment on the payday loan industry.¹⁶ The report featured a woman with multiple sclerosis living in Portland, Oregon who took out a payday loan of \$150 in order to purchase orthopedic shoes.¹⁷ When the loan's repayment was due, the woman lacked the money and decided to take out another payday loan to pay off the first one.¹⁸ This perpetual borrowing cycle con-

⁸ *Id.*

⁹ *Id.*

¹⁰ *Guidelines for Payday Lending, supra* note 6.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ Bosworth, Martin, *H&R Blocked, Again*, Consumer Affairs, December 22, 2005, http://www.consumeraffairs.com/news04/2005/hr_block_payday.html.

¹⁵ *Dan Rather Reports' Criticizes Payday Loan Industry*, Payday Loan Industry Watch, November 23, 2006, http://www.pliwatch.org/news_article_061123A.html.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

tinued.¹⁹ The woman commented, "I just went right across the street and borrowed the money. It was that easy. Only takes about 20 minutes. They're nice. They have candy."²⁰ Eventually, the woman owed money to nine different payday loan institutions and, due to the accumulated service charges, all of the money from her regular social security checks went to her lenders.²¹ Consequently, the \$140 shoes she purchased with the initial loan cost her over \$2,000.²²

Borrowing nightmares such as this caused many states to crack down on lending institutions offering quick cash at unreasonable interest rates.²³ In Illinois, the Payday Loan Reform Act (PLRA) came into effect in December of 2005.²⁴

Illinois Governor Rod Blagojevich stated, "[w]hen a working family looks for financial assistance to help them get through a hard time, they shouldn't end up in worse debt. But that's what was happening all over Illinois when payday lenders were free to charge outrageous interest rates and collect hidden fees."²⁵

The PLRA now allows indebted Illinois consumers the option of choosing a no-interest payment plan to get caught up in their payments without additional interest.²⁶ Furthermore, the PLRA does not allow lending institutions to charge interest rates higher than \$15.50 per \$100 loan.²⁷ The PLRA also limits the additional fees and charges lending institutions may charge for late payments and lack of sufficient funds.²⁸ Since the PLRA has been signed into law, Illinois consumers have saved approximately \$6.4 million in loan fees and interest charges.²⁹

¹⁹ *Dan Rather Reports' Criticizes Payday Loan Industry*, *supra* note 16.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Blagojevich's Payday Lending Reforms Save Illinois Borrowers \$6.4 Million*, Payday Loan Industry Watch, October 31, 2006, http://www/pliwatch.org/news_article_061031A.html.

²⁴ *Id.*

²⁵ *Id.*

²⁶ 815 ILCS 122/2-40 (2006).

²⁷ 815 ILCS 122/2-5(e) (2006).

²⁸ 815 ILCS 122/2-10 (2006)

²⁹ *Blagojevich's Payday Lending Reforms Save Illinois Borrowers \$6.4 Million*, *supra* note 24 (noting that in the past 10 months, Illinoisians have borrowed \$136 million in payday loans and have paid approximately \$20.8 million in loan fees and interest charges. The average Illinois payday loan is for \$334.69, and the

Similarly, Florida passed a cash-advance law in 2001 that limits people to one \$500 loan at a time and limits lenders to a 10 percent interest rate.³⁰ Furthermore, the Florida law prohibits lenders from transferring unpaid loan balances onto the balance of a second loan.³¹

Other states have passed laws making it harder for lending institutions to recover large amounts of money from borrowers in court proceedings.³² In California, Attorney General Bill Lockyer recently filed a \$2 million suit against Fast Cash, a payday lender, due to Fast Cash's suits against borrowers where it demanded treble damages.³³ Normally, California law enables a plaintiff to obtain treble damages against a defendant who has bounced a check.³⁴ However, in California, payday lenders are limited to recovering only the amount due with an additional \$15 fee.³⁵ Fast Cash sued 400 individuals and received treble damages.³⁶ Currently, Lockyer is suing to get that money back for the borrowers.³⁷

While state governments are attempting to curtail what they perceive as predatory lending by payday lenders, many payday lenders have simply moved online to avoid state regulations.³⁸ Many lenders operate payday Internet sites in states with lax restrictions in order to do business in states with more stringent regulations.³⁹ Some online lenders operate under disclosure statements that inform

borrower pays about \$51.07 in fees and interests, or \$15.30 for ever \$100 borrowed. Before the PLRA took effect, the average fee for short term loans was \$20 per \$100 borrowed. Had the law not been in effect, Illinois consumers would have paid \$27.2 million in loan fees and interest charges on that money).

³⁰ *Turning Payday Into Profit*, Payday Loan Industry Watch, August 20, 2006, http://www.pliwatch.org/news_article_060820A.html.

³¹ *Id.*

³² *California Attorney General Files \$2 Million Lawsuit Against LA Payday Loan Business*, RTO, August 2, 2006, http://www.rtoonline.com/content/Article/Aug_06/CaliforniaAGFilesSuitPaydaylender080206.asp.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *California Attorney General Files \$2 Million Lawsuit Against LA Payday Loan Business*, *supra* note 34.

³⁸ *Payday Lenders Use Internet to Avoid Law*, USA Today, December 1, 2004, http://www.usatoday.com/tech/news/2004-12-01-usurious-lending-online_x.htm.

³⁹ *Id.*

the consumer that they are operating under the laws of a given state, even if the consumer is not located in that state.⁴⁰ For example, one online lender has a disclosure statement on its website that notes, “[a]ll aspects and transactions on this site will be deemed to have taken place in our office in the State of Delaware, regardless of where you may be viewing or accessing this site.”⁴¹ However, many people believe that payday lenders operating on the Internet should be subject to the same state regulations to which payday lenders operating storefronts within the state are subject.⁴² Prentiss Cox, a former Minnesota assistant attorney general says, “[i]f they’re making the loan to Minnesota residents, there’s no reason that Internet payday lenders shouldn’t be complying with the laws.”⁴³

This is the message that West Virginia Attorney General Darrell McGraw is trying to send to Internet lenders in West Virginia.⁴⁴ McGraw recently reached settlement agreements with eighteen Internet payday lenders in which the lenders promised that they would stop lending via the Internet in West Virginia and would refund any unlawful fees and charges to West Virginia consumers.⁴⁵ Now, with the recent suit to enforce investigative subpoenas against fourteen other Internet lenders, McGraw has commenced a legal battle to try and force other lenders to comply with West Virginia law.⁴⁶ In a recent release, McGraw stated, “[I]ast year we launched a major initiative to combat companies that were using the Internet to circumvent the laws of West Virginia intended to protect consumers from usurious loans. Today, we have sent a message that loans made to West Virginia consumers over the Internet must comply with our laws. We will take whatever legal action is necessary to protect our consumers from Internet predators.”⁴⁷

⁴⁰ Huffman, *supra* note 2.

⁴¹ *Id.*

⁴² Rizzo, Paul, *Online Payday Loans in Minnesota: Skirting State Law, Hurting Consumers?*, Payday Loan Times, October 23, 2006, <http://www.paydayloantimes.com/categories/minnesota>.

⁴³ *Id.*

⁴⁴ Huffman, *supra* note 2.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ *Attorney General Darrell McGraw Reaches Settlement Agreement with 18 Internet Payday Lenders*, Office of West Virginia Attorney General, November 6, 2006, <http://www.wvago.us/consumernews/viewtopic.php?t=170>.