Commentary: The Case for Consumer Litigation

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by Alvin C. Harrell

Consumer litigation in 1998 continues to confront two inescapable facts: (1) There is a need for legitimate subprime credit for those who do not meet traditional standards of creditworthiness, and this credit must necessarily be on terms and at a cost commensurate with the risks as evaluated and agreed upon by the creditor and consumer, or it will...

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Appendix B—Summary

<table>
<thead>
<tr>
<th></th>
<th>No Games 18% Risk Rate</th>
<th>No Games 27% Risk Rate</th>
<th>To Cover 20% Discount</th>
<th>To Cover 45% Discount</th>
<th>Combined really high rate credit + inflation of CP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Cash Price</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Inflated “Cash Price”</td>
<td>NA</td>
<td>NA</td>
<td>$6,250</td>
<td>$9,100</td>
<td>$9,100</td>
</tr>
<tr>
<td>Disclosed Interest Rate</td>
<td>18%</td>
<td>27%</td>
<td>18%</td>
<td>18%</td>
<td>27%</td>
</tr>
<tr>
<td>Real Credit Cost as Rate</td>
<td>18%</td>
<td>27%</td>
<td>38.8%</td>
<td>68.2%</td>
<td>80.7%</td>
</tr>
<tr>
<td>Monthly Payments (36)</td>
<td>$180.75</td>
<td>$205.13</td>
<td>$225.95</td>
<td>$329</td>
<td>$372</td>
</tr>
<tr>
<td>Total of Payments</td>
<td>$6,507</td>
<td>$7,348.47</td>
<td>$8,134</td>
<td>$11,844</td>
<td>$13,375</td>
</tr>
</tbody>
</table>

Now—assume loan made to buyer with $600/month income—who’s created the risk?

Congress OKs Yield-Spread Premiums and Directs HUD to Take Action

The Conference Report accompanying H.R. 4194, the 1999 VA-HUD appropriations legislation, includes the following direction to HUD:

The conferences are concerned that HUD has invested considerable time and resources in developing a policy statement that clarifies its position on lender-paid mortgage broker fees and their legality under the Real Estate Settlement Procedures Act. Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of subsections (a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA. Publishing a policy statement could provide invaluable guidance to consumers, brokers, and the courts. The conferences are concerned about the legal uncertainty that continues absent such policy statement. The conferences direct HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of this appropriation Act. The conferences expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement.

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system be structured to help protect the latter without adding unnecessary costs and burdens that stifle their needs?

There is nothing new about these issues or problems—they have been around since the dawn of civilization and have been formalized and thoroughly confronted by common law courts and institutions for over 300 years. The best solution that anyone has identified to date is private consumer litigation, in the context of legal rules that are reasonably clear and simple and are applied consistently on the basis of the common law model. This is not a perfect solution, in fact in some ways it is unsatisfactory, but it is far better than any alternative ever devised.

Some may argue that individual borrowers are inherently at a disadvantage as against large creditors, but creditor competition and advertising, disclosure requirements and consumer protection laws, consumers' basic common sense, aggressive plain-tiff's lawyers, contingency fee arrangements, legal aid clinics, consumer advocacy groups, and class action lawsuits largely negate any such advantage. The very large amount of consumer litigation suggests...
Bibliography

Statutes:


Tex. Bus. & Comm. Code Title 20,


Regulations:

16 CFR § 604(3)(a).


FIL-62-91.

Articles:


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suggests that this is not a problem. A more realistic problem is the disadvantages faced by small community lenders (long a bulwark against widespread credit abuse in local communities) in an age of giant competitors, an aggressive plaintiffs’ bar, and regulators who may respond largely to the needs of larger institutions.

Ironically, consumer credit law problems (including an overly complex litigation and regulatory framework that tends to raise costs for consumers) are often reinforced by those claiming to represent consumer interests (though some creditor representatives are likewise implicated). Many of those in positions of influence seem unconcerned about the cost impact and complexity of the regulatory and litigation burden. This is true of creditors and others who have largely abandoned any effort to accommodate the system of independent community lenders that has been so much a part of economic progress in the 20th century.

It is axiomatic that we have moved dramatically away from clarity and simplicity in much of the consumer credit law. Nearly everyone in a position of authority likes this trend. Large lenders seem to like it, judging from the complexity of their loan products. Consumer advocates also find it, possibly because it creates new opportunities for actionable creditor errors and litigation. Consumers seem to like it, as they have more credit choices and tailor-made credit programs. Regulators like it, and also creditor lawyers, as it justifies their jobs and keeps them in business. Constant change also helps in this regard. The media benefits as well, as the changes and complexities pay a premium on marketing savvy and advertising expenditures.

And so the institutions of society move us inexorably toward complexity, less clarity, and anything but simplicity. Modern consumer credit litigation and regulations increasingly focus on the legal equivalents of how many angels can dance on the head of a pin. arcane Truth in Lending (TIL) and other consumer compliance arguments are used as a proxy to combat fraud and unconscionability; statistics and regulations are manipulated by public officials in pursuit of a political agenda; enforcement actions punish or even destroy private businesses on the basis of technical errors involving hopelessly complex regulations; allegations of disclosure violations go far beyond anything of value to the consumer, and consume enormous resources that raise the cost of credit to those who need it most. The system is messy, in some respects even corrupt, and it is abused by some of those who complain most loudly about abuse.

And yet it works. More credit, of more types, is available to more people than ever before. In some ways this has happened despite the best efforts of our public institutions. There are creditors who have pushed the limits of conscionability; regulators who have sought to disrupt or displace free markets; lawyers, politicians and regulators who seek to enrich themselves at the expense of lenders via a burdensome and costly compliance regime; all of these have failed to impair the consumer credit markets. Partly this merely demonstrates the overpowering force of free markets. The widespread deregulation of interest rates has allowed the market to adjust to costly regulatory and litigation burdens by increasing the cost of credit. As long as the courts recognize basic contract and property law concepts, and the states allow market entry and provide reasonable chancery alternatives and an acceptable rate environment, competition and free markets will likely overcome any hurdles placed in their path.

And, as it has been for 300 years, consumer litigation will be there to shave off the rough edges.

Uniform disclosure of essential terms has come to be an essential part of this, and most observers today endorse the basic principles of TIL law. Your author’s experience has been that the vast majority of consumers know and understand their basic loan terms, and TIL clearly has played a role in this. Together with common law contracts and fraud concepts, the Uniform Commercial Code, and reasonable state consumer protection laws such as the Uniform Consumer Credit Code, this provides important consumer protections against abuse, and consumer litigation has proved to be the only effective enforcement mechanism. Arguably the

2. It should be noted that these are under increasing attack in some quarters.
The financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound under Section 9-203(c) unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under Section 9-507(a).

Subsection 9-508(a) provides that where a new debtor (e.g., Webb Expanded, Inc.) acquires rights in the collateral of the original debtor (e.g., Webb Metals, Inc.), the financing statement filed under the name of the original debtor will continue to be effective for perfection to the extent it would have been effective against the original debtor. However, if the names of the original and new debtor are so different that under section 9-506 the financing statement is seriously misleading as to the new debtor, the financing statement is effective only as to collateral required before or within four months after the date the new debtor becomes bound by the security agreement.

(d) A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:

1. the security agreement becomes effective to create a security interest in the person's property; or

2. the person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

Subsection 9-203(d) contemplates that a new debtor may become subject to a security agreement executed by the old debtor, without signing the security agreement, in the enumerated circumstances, as in Union.50 In such a case, the analysis will then shift to sections 9-506 and 9-508, to determine if any difference in the names of the two debtors is seriously misleading so as to require a new financing statement with regard to collateral acquired by the new debtor more than four months later.

VIII. Conclusions

Revised Article 9 does a commendable job of ending the current game of Russian Roulette—UCC Style. It addresses the major problems and uncertainties discussed in this article, while eliminating some of the rough edges in the current statute (which have probably contributed to some of the aberrant case law).

Revised Article 9 is as clear as it could be on these issues, and indeed could be of use to courts confronting these issues under current law.51 If revised Article 9 is enacted, the courts will have very little excuse to play the name game with secured parties in the future.

48. See supra note 12.
49. Id.
50. 871 P.2d 422. See supra Pt. II-B. Recall that in Green the court rejected the creation of a new category (Webb Expanded) of a change in structure, partly on the basis of a creative merger theory developed by one of your authors. While questionable under current Article 9, the same result could be appropriate under revised § 9-203(d)(2).
51. Despite the disclaimer on the cover of every NCCUSL draft.

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III. Preemption of Prepayment Fee Prohibitions

A. Letter from Reginald S. Evans, Chief Counsel, Department of Banking, Pennsylvania, to Barbara S. Mishkin, Esquire (March 17, 1997)

In a recent letter issued by the Pennsylvania Banking Department, it was confirmed that the prepayment fee prohibition under both the Mortgage Bankers and Brokers Act and the Secondary Mortgage Loan Act are preempted by the Federal Alternative Mortgage Transaction Parity Act of 1982 (AMTPA). Under AMTPA, mortgage loans that have variable rates, balloon payments or other arrangements different from traditional fixed rate/ term mortgage loans may be made by “housing creditors” other than banks and credit unions under regulations applicable to federal savings associations. Those regulations permit prepayment fees.

In addition, the Maryland Attorney General has also issued an opinion confirming this preemption for Maryland law and a similar opinion has been requested of the New Jersey Department of Banking and Insurance.

IV. Arbitration Issues

A. Basil v. Green Tree Financial Corp. 11

Plaintiffs brought a class action suit alleging that the defendant, Green Tree Financial Corp., failed to inform them of their right to legal counsel in closing transactions. Because each agreement signed by the plaintiffs included an arbitration clause, defendant moved to stay the proceedings and compel arbitration. The Court of Appeals of South Carolina agreed with the trial court insofar as it found that the agreements in this case were adhesion contracts; however, the appellate court did not find that the terms of the contract were unconscionable. “Determining whether the contract is one of adhesion is merely the beginning point in the analysis. Unconscionability, on the other hand, requires greater showing,” the Court said.

In addition, the Court noted that “where the contract is subject to the FAA, this Court must defer to legislative policy and may not view arbitration as an inherently less beneficial form of dispute resolution. Furthermore, the respondents have failed to demonstrate that they were unable to get the same relief in arbitration which was available in a judicial setting...we conclude that a party desiring to avoid an arbitration clause on the grounds that no reasonable person would have agreed to it merely because it precludes judicial remedies must demonstrate how he or she has been prejudiced by compelled arbitration.”

B. Luckey v. Green Tree Financial Corp. 15

The plaintiff, Christine Williams, purchased a satellite television system with a private label credit card issued by Beneficial. Under the original cardholder agreement, Beneficial obtained the right to change the terms of the agreement. In late 1996, Beneficial elected to add a provision stating that any disputes relating to the cardholder agreement would be resolved by arbitration if elected by either party. This “change in terms” notice mailed to the plaintiff in her monthly account statement gave its cardholder the right to opt out of the arbitration provision by sending notes to Beneficial within thirty days.

The Court rejected plaintiff’s argument and granted Beneficial’s motion to compel, emphasizing that the original cardholder agreement allowed for a change in terms by mailing notice. This is founded on Delaware law which authorizes banks to reserve the right to modify the terms of credit card agreements through “passive consent” or “debit ratification.” This case stands for the proposition that to hold the “change in terms” notice out as ineffective would be to place arbitration contracts in an inferior position to other contracts in accordance of the FAA.

12. 95 S.C. 260 (7th Cir. 1995).