Commentary: Consumer Credit in the 1990s, Part One - The Increasing Importance of State Law

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By Alvin C. Harrell

1. Renewed Growth of the State-Chartered Credit Industry

In past years, some observers have noted an increasing federalization of commercial and consumer law, that federal law and institutions will continue to grow at the expense of state laws and institutions.

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tour of duty and will resume after his or her separation from active duty. This is true even if the foreclosure took place before the service member was called to active duty, as long as the redemption period had not expired by the date he or she received orders to report for duty.

Various states have also enacted laws similar in purpose to the federal statute and lenders would also need to comply with these state laws.

XIV. New Jersey Fair Foreclosure Act

The New Jersey Fair Foreclosure Act which went into effect on December 4, 1995, was enacted to streamline the New Jersey foreclosure practice, as well as provide New Jersey residential homeowners with additional consumer protections.3 Residential mortgages covered under the Act include mortgages on one to four-family dwellings which are occupied by the borrower or a member of the borrower’s immediate family. The Act makes no distinction between those situations where the mortgage loan was for a personal use or a commercial use. Therefore, a commercial loan which is secured by a consumer’s principal dwelling would be covered by the Fair Foreclosure Act.

The Fair Foreclosure Act provides an “optional foreclosure procedure without sale.” Under this procedure, a lender could obtain judgment and sell the property without a sheriff’s sale by obtaining an order from the Office of Foreclosure of the Superior Court. The optional foreclosure procedure may only be used by a lender where the borrower has abandoned the property, voluntarily surrendered the property through a deed in lieu of foreclosure, or where the borrower has no equity in the property. If the optional sale procedure is used, the debt which was secured by the mortgage is deemed satisfied, and the lender is not permitted to pursue further action to collect the debt.

The optional sale procedure is designed to shorten the New Jersey foreclosure process.

The Fair Foreclosure Act also provides new protections for homeowners who default on their mortgages. Prior to acceleration of a mortgage and the commencement of foreclosure or other legal action, the mortgagor must give at least 30 days prior written notice of its intention to foreclose to the mortgagor. The notice of intention to foreclose must include a detailed 11 point disclosure which, among other things, notifies the borrower of their right to cure the default and the consequences of the borrower not curing the default. Additionally, the Fair Foreclosure Act gives the mortgagor a right to cure and reinstate a defaulted mortgage loan after acceleration and the initiation of foreclosure proceedings once every 18 months. This limitation on the right to cure does not apply if the mortgagor cures the default by the date specified in the notice to cure.


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In addition, the consolidation of the federally regulated banking system has left a void being filled by state-chartered nonbank lenders operating primarily under state law.4 Ironically, federal efforts to increasingly mandate the policies of federal banking institutions (partly in an effort to promote greater credit availability) has resulted in an excessive regulatory burden and a federal banking system that is less able to meet the financial needs of the entire public.5

In response, state-chartered and primarily state-regulated lenders have expanded to fill these needs. This growth in state-chartered lenders, which includes everything from check-cashing services, pawn shops, sub-prime auto lenders, specialized home equity lenders, and secondary market icon purchasers to credit and companies, finance companies, and state banks, thrifts and credit unions, has created a strong parallel financial system on the national banking system. It also has provided the states an opportunity to assert greater control over their financial destiny and to provide a legal and regulatory environment conducive to financial competition and local credit availability.

II. The Importance of State Laws

As a result of these developments, state consumer credit laws have become more important than ever, in terms of creating a legal environment that promotes competition, the availability of credit, and the development of state-chartered financial service providers.

For example, it is essential that state law provide clear and simple rules that lenders can follow
the plain meaning of the statute, holding that the word "any" within the exemption, meant exactly that. This decision is a major victory for the creditor community.

The one remaining issue yet to be resolved by our high court involves the assessment of non-filing insurance in the context of a purchase money-secured transaction. This issue will be before the Supreme Court in connection with the appeal of Whitson v. Warehouse Home Furnishings Distributors, Inc. (Farmer's Furniture).5

There remains a number of areas of concern for financial institutions and creditors. The proper writing of creditor-placed insurance and the calculation of the premium for the same are the subject of numerous lawsuits in Alabama. The issue of "upcharging" for ancillary services in connection with consumer credit transactions is under attack in other lawsuits. Still other consumer advocates are taking a hard look at "deep discounting" and yield spreads, in the context of both hidden finance charges and the fair lending laws.

It is important that interested parties remain vigilant in reviewing creditor practices and procedures to make absolutely certain that not only are creditor clients complying with the letter of the law, but that they are explaining to their consumer customers exactly what those practices and procedures entail. No one more than the finance industry wants certainty and precision with respect to the appropriate disclosure of the credit transaction to the consumer.


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Fortunately there is a model for the states to follow in pursuing the stated goals: The Uniform Consumer Credit Code (UCC). Articles in this issue by Professor Fred H. Miller and the next issue by David B. McMahon discuss the past and future of the UCC, and that discussion will not be repeated here. But states willing to consider reform of their state consumer credit laws need look no further than the Oklahoma UCC as the basis for a model to consider.

In terms of consumer credit law and regulation, Oklahoma is fortunate. The Oklahoma UCC would be a prime candidate for the honor of best consumer credit statute in the United States. Lenders from other states entering the Oklahoma market often marvel at the relative clarity and simplicity of Oklahoma law. The unnecessarily burdensome laws of many other states suffer by comparison. Yet, as noted by Professor Miller in this issue, the Oklahoma UCC is not perfect. Could this law be made even better?

One is always hesitant to reopen the Pandora's Box of a legislative process with regard to a comprehensive code that, overall, is working well in its current form. Perhaps it would be a mistake to jeopardize a state legal environment that already is encouraging the development of competitive state-chartered enterprises. Nonetheless, Professor Miller's article suggests reasons to consider revision of the UCC, perhaps in conjunction with a

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entities regulated by the Oklahoma Department reflects a significant increase in the scope of the Department's jurisdiction, as demonstrated by a marked increase in the number of independent Finance companies. While the dramatic increase in the number of creditors

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federal supremacy in the regulation of credit card interest charges also makes sense, since, in many respects, "credit cards have replaced the national currency." The dissent concluded that RISA impermissibly interferes with the Congressional goal of preventing states from discriminating against national banks. Moreover, the dissent protested that, since several other New Jersey laws permit credit card late charges for certain New Jersey-based lenders, the majority's holding only increases the discriminatory impact on non-New Jersey-based banks.

VI. U.S. Supreme Court Resolves Conflict

On June 3, 1996, the United States Supreme Court issued its much awaited decision in Smiley v. Citibank, a similar case from California involving late fees. The court, in a unanimous 9-0 decision, held that national banks may charge nationwide credit card late fees permitted by their home states, even to card holders who live in states where such fees are prohibited. The court determined that "interest" does encompass late-payment fees. In doing so, the court relied heavily on the Comptroller of the Currency's determination that late fees and other similar credit card fees such as annual fees and overlimit fees are "interest" under section 85 of the NBA. In light of the Supreme Court's deference to the Comptroller and because the "Comptroller's interpretation of section 85 is a reasonable one," the Court held in favor of Citibank.

Smiley resolves the conflict created in part by the New Jersey Supreme Court decision and will no doubt sound the death knell to the various class action cases throughout the country challenging not only late fees, but also annual fees and other credit card charges.

A week after rendering its decision in Smiley, the Supreme Court, on June 10, 1996, remanded the Sherman case (No. 95-991) and the Hunter case (No. 95-963) back to the New Jersey Supreme Court for further consideration in light of Smiley.

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regional or national effort to update and unify state consumer credit laws. Clearly there is a danger in doing nothing at the state level. If the states fail to provide a workable and uniform legal environment for the 21st century, it is likely that events at the federal level will pass them by.

IV. Federal Preemption and the U.S. Supreme Court

At this writing, the United States Supreme Court has just decided an important case dealing with federal preemption of state consumer credit laws by federal banking regulators. This decision is likely to raise the stakes for states that fail to reform their consumer credit laws, and absent concerted state action may reverse the trend toward state law and institutions noted in this Commentary.

The United States Supreme Court took a broad view of federal banking regulatory preemption, and as a result the states may find themselves in danger of footing control over their financial systems to out-of-state institutions and federal banking regulators. In addition, where states have created unworkable or punitive consumer credit codes (perhaps in an effort to protect consumers), the effort will be to

punish local lenders and provide a competitive advantage for large out-of-state institutions. Unless this is corrected, it will encourage the decline of local lenders and promote abdication of the states' responsibility to foster a healthy and competitive consumer credit environment.

Again, the alternative is to modernize, simplify, and clarify state consumer credit laws in a uniform effort to provide a workable, national environment without federal preemption.

V. Conclusion

Perhaps the time has come for state consumer law specialists (on both the consumer and creditor sides?), banking and consumer credit administrators, trade associations, and legislative leaders to recognize the need for improved and uniform state consumer credit laws. Consolidation of the federal banking industry, the potential for expansion of needed competition from state-chartered lenders, and the increased impact of federal preemption in the aftermath of Smiley have increased the importance of state law and created a window of opportunity for the states to assume a leadership role in creating a competitive consumer finance system for the 21st century. But it will require the will and leadership at the state level to meet the challenge.

8. Some states have already recognized this effect in the context of federal preemption of state law insurance restrictions. These preemption benefits national banks at the expense of state-chartered institutions. See, e.g., David W. Roderick, Competition and the Balance: The United States Supreme Court's Garnier Bank Sales of Insurance, 50 Consumer L. Q. Rep. 7 (1995). But addressing the equitable problem in the context of consumer credit laws will require a more uniform approach.

9. This is an issue that should cut across the lines that divide debtor and creditor concern. Both lenders and consumers represented have an incentive to favor clear and uniform rules of law that all can understand. Simplicity and clarity are also essential to encourage market entry and competition. For consumers, there can be no greater protective mechanism than a legal environment that will encourage competition and can be understood and enforced by the local bar.