From status to contract: evolving paradigms for regulating consumer credit

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INTRODUCTION

In the last four decades something radical has happened in the United States consumer economy: The ordinary, middle class homeowner has gained a new means for borrowing thousands of dollars. While consumers have long had the option of using their homes as collateral for loans, they now can use credit cards to borrow large sums without any security for those loans.

1. According to Sir Henry Sumner Maine (1822-1888), “the movement of the progressive societies has hitherto been a movement from Status to Contract.” HENRY SUMNER MAINE, ANCIENT LAW: ITS CONNECTION WITH THE EARLY HISTORY OF SOCIETY AND ITS RELATION TO MODERN IDEAS 165 (10th ed. 1963) (1861) (alteration in original). This article suggests that such a movement does not necessarily signify progress in the area of consumer borrowing.

2. Associate Professor of Law, Northeastern University School of Law. I am grateful to Judith Olans Brown, Peter Enrich, Benjamin Ericson, Ingrid Michelsen Hillinger, Grant Nelson, Daniel Schaffer, and Joseph William Singer for their invaluable comments to prior drafts, and to James Hackney, Cathy Lesser Mansfield, David Phillips, and Elizabeth Warren for stimulating conversations about this project. I received terrific research assistance from Matthew Greene, Elizabeth Leduc, Michelle Moor, and Aimee Owen, unparalleled administrative support from Jan McNew, and unending research support from the staff at the Northeastern University Law Library.

3. This article uses the term “consumer” to distinguish between individuals and businesses. I focus exclusively on individual borrowing and developments in consumer credit in this country.

4. While other means of consumer borrowing, such as bank signature loans, installment credit, and small unsecured loans from consumer finance companies, did exist prior to the invention of the credit card, see ROBERT D. MANNING, CREDIT CARD NATION 3-4 (Basic Books 2000); NATIONAL CONSUMER LAW CENTER, STOP PREDATORY LENDING 4-6 (2002) (hereinafter STOP PREDATORY LENDING), mortgages were by far the most ubiquitous and traditional means of consumer borrowing. See RALPH J. ROHNER & FRED H. MILLER, TRUTH IN LENDING 245 (Robert A. Cook et al., eds., 2000).

5. My claim that credit card borrowing is approximately forty years old is based on the invention in the late 1950s of BankAmericard, Visa, and MasterCard credit cards, which were the first general purpose credit cards to allow borrowers to carry balances from month to month. DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 10-11 (The MIT Press 1999); MANNING, supra note 4, at 84-86; TERESA A. SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS 109 (Yale University Press 2000); Oren Bar-Gill, Seduction by Plastic, 98 NW. U. L. REV. 1373, 1381 (2004). Arguably, however, credit card borrowing began several decades earlier with the introduction of merchant-specific credit cards, such as the card Sears Roebuck & Company offered. MANNING, supra note 4, at
This article explains the legal shift that accompanied this new type of loan transaction and explores changes in the credit relationship. While careful and extensive legal scholarship draws attention to the dramatic changes the credit card has made to the landscape of consumer credit, the focus has been on explaining the lure of credit cards to consumers and the key legal moments that promoted the credit card. The effect of credit cards on borrowers' legal rights has remained largely unexamined.

This article seeks to fill that gap. Using mortgage lending as the historical paradigm, I claim that credit card lending creates a new legal paradigm of an individual borrower. Whereas mortgage law crafted non-waivable property rules to protect the ignorant borrower from exploitation by the lender, credit

83-84; Bar-Gill, supra, at 1381.


9. The term "ignorant" directly reflects legal treatment of residential mortgagors and is not intended to be pejorative. See, e.g., Earls v. Chase Bank of Tex., 59 P.3d 364, 368 (Mont. 2002) (finding that "the [statutory] acknowledgment of notice requirement was intended to protect less sophisticated borrowers" (citation omitted)); Westervelt v. Gateway Fin. Serv., 464 A.2d 1203, 1208 (N.J. Super. Ct. Ch. Div. 1983) (stating that the purpose of New Jersey's Secondary Mortgage Loan Act is "to protect the ignorant, the choiceless and the often overreached"); S. REP. NO. 103-169, at 22 (1993) (stating that "[e]vidence before the Committee indicates that some high-rate lenders are using non-purchase money mortgages to take
card law relies on largely waivable contract rules to afford the enlightened borrower greater access to credit. Mortgage law traditionally protected ignorant borrowers' ownership rights in their collateral. Credit card law regulates the disclosures made to enlightened borrowers to ensure that they have enough information to make good bargains. This switch in borrower paradigms elicits drastically different results and less favorable treatment of the typical, middle class consumer borrower in courts, Congress, and the market.

Part I explores the development of the ignorant borrower paradigm in mortgage law and the enlightened borrower paradigm in credit card law. The two paradigms are historical products of the social and legal policies of their days. Their coexistence, however, is not a logical response to consumer behavior in the market for credit. For the consumer, the choice between borrowing regimes is much more subtle, and the losses can be equally devastating. Consequently, the treatment of the borrower as ignorant in one instance and enlightened in the other is far less rational.

Having established the existence of the two paradigms, Part II explains the consequences of this paradigm shift. Part II.A. discusses the effect of the two paradigms on borrowers' rights, remedies, and days in court. Briefly, judicial use of mortgage law's ignorant borrower paradigm facilitates a more contextualized review of a credit transaction and creates opportunity for specific and meaningful remedies. The contract language in credit card cases, however, constrains judicial review; as long as fraud, unconscionability, or similarly egregious behavior does not occur in the formation of the contract, the contract provisions limit the borrowers' rights. Part II.B. suggests that what the mortgage market deems aberrant and predatory behavior the credit card market considers mainstream and acceptable. The enlightened borrower paradigm contributes fundamentally to this redefinition of lending norms. Part II.C., however, shows that the law responds to this important shift in the credit market with a continuing reliance on disclosure to remedy abuses in the credit card market.

Part III considers the future. The current legal environment in which the two borrower paradigms coexist is unstable, and disclosure appears to be the favored form of regulation. In continuing to respond to credit card borrowing, lawmakers should focus more attention on the role of this new form of credit in accomplishing important social goals.
I. THE EMERGENCE OF TWO PARADIGMS

Statistics on individual debt in this country abound. Sixty-nine percent of Americans own their own homes, the vast majority financed with mortgages. In addition, home equity borrowing is a growing industry, totaling $415 billion by the middle of 2003. Meanwhile, as of 2000, approximately seventy-seven percent of American households had at least one credit card. Of the seventy-five percent of these individuals who carry balances from month to month, the average credit card debt is a shocking $12,500. These numbers suggest that many Americans carry significant amounts of both mortgage and credit card debt. As described by Professors Sullivan, Warren and Westbrook, "From 1980 to 1994, total household debt had increased from 65 percent to 81 percent of total income. In short, real


13. A home equity loan is “secured by a homeowner’s residence other than loans used solely to purchase or construct the residence, to refinance a purchase money loan, or to make home improvements.” Julia Patterson Forrester, Mortgaging the American Dream: A Critical Evaluation of the Federal Government’s Promotion of Home Equity Financing, 69 TUL. L. REV. 373, 377 (1994). Consumers use such loans to finance everything from school tuition to groceries or luxury items.

14. David Myron, Home Equity Debt Soars, AMERICAN DEMOGRAPHICS (Nov. 1, 2004), available at http://www.findarticles.com/p/articles/mi_m4021/is_9_26/ai_n6344044 (relying on statistics maintained by the Federal Deposit Insurance Corporation). Home equity loan growth outpaced even credit card borrowing. Id. 2003 Census data show that home equity lump-sum mortgages, lines of credit, or both encumber more than 15% of homeownership in the United States. U.S. Census Bureau, supra note 12.

15. MANNING, supra note 4, at 317 n.11. This figure refers to “bank” or all-purpose credit cards. Id. Manning also notes that the average number of cards per cardholder is ten, including bank, retail, phone, gasoline, and travel and entertainment cards. Id. at 6. See also Bar-Gill, supra note 5, at 1384 (stating on the basis of a 1995 study “that 80% of [American] households have at least one credit card”).

16. SULLIVAN ET AL., supra note 5, at 110-11.

17. Bar-Gill, supra note 5, at 1385.
consumer debt has risen dramatically over a long period during which real incomes for many people have stayed the same or declined. 18

But the law does not treat all consumer debt alike. This section compares the law that governs the two major regimes of consumer borrowing, mortgages and credit cards. 19 The law has played an integral role in promoting these two forms of debt, but they are not products of the same law or promoted by similar policies. Consumer advocates and scholars alike have noted a deregulatory impulse in both arenas, which many argue results in significant exploitation of borrowers. Yet, the law has managed the difficult balance between access and exploitation very differently in these two arenas. These differences, despite being significantly consequential to the average consumer, often are not recognized.

A. Mortgages: The Ignorant Borrower

A cursory description of the history of mortgage law is that it consists of almost four hundred years of regulation designed to protect borrowers from loss of their collateral and approximately twenty-five years of deregulation designed to empower borrowers to greater participation in the market for credit. 20 The

18. Sullivan et al., supra note 5, at 18.


For a legal history of credit cards, see, e.g., Manning, supra note 4; Sullivan et al., supra note 5, at 109-11; Bar-Gill, supra note 5, at 1380-83.

20. While not a result of deregulation, the shift towards greater market participation arguably started shortly after the Great Depression, which caused an unprecedented number of foreclosures and incidents of homelessness. In response, the government created the Federal Housing Administration (FHA) in 1934, followed by the Federal National Mortgage Association (commonly referred to as Fannie Mae) in 1938. These developments helped support the secondary mortgage market and made mortgages available to more borrowers. Burkhart, supra note 19, at 272-74; Cathy Lesser Mansfield, The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market, 51 S.C. L. Rev. 473, 477 (2000). Efforts to provide homeownership opportunities to World War II veterans also contributed to increased access. In particular, FHA and Veterans' Administration-insured loans made mortgage credit easier to attain. See Mansfield, supra, at 480-484; U.S. Department of Housing and Urban Development, The
regulatory phase appears to have been a process of accretion, in which courts, and later legislatures, sought to limit lenders' various forms of exploitation. These lenders typically had more bargaining power, resources, and sophistication than their borrowers. The law during this period evidences a clear theme: State courts and legislatures consistently overrode mortgage contract terms to help borrowers retain their collateral. Despite the recent deregulation of the consumer mortgage market, some pro-borrower sensitivity remains today in the law of mortgage lending. The earliest and perhaps greatest achievement of the regulatory phase was the creation of the equity of redemption. Before the equity of redemption existed, a mortgage lender typically required the borrower to transfer to the lender the borrower's fee title to the collateral at the time of contract formation. Common law courts strictly enforced this transfer, even when the loan terms were extremely onerous, unless the borrower repaid the loan according to the terms of the contract. For example, where the loan agreement required a borrower to make a lump sum payment on a given date and the borrower violated the agreement merely by repaying the loan on the day after, the default resulted in his loss of the collateral.


21. The regulatory period was initiated by English courts of equity and ultimately supplemented by state legislatures in the United States. See generally Osborne, supra note 19, at 12-25 (providing historical background).

22. Importantly, as predatory lending practices demonstrate, this sensitivity is not necessarily reflected in the practice of mortgage lending, as opposed to the law. See infra Part II.B. As discussed in greater detail in Part III.A., the abuses in the market for consumer mortgages argue in favor of more stringent pro-borrower regulations.

23. Under the common law rule, the lender received all of the incidents of fee simple title, even though this was "antagonistic to the sole purpose of the conveyance, namely, security for the performance of an act by the grantor. Thus... creditors of the grantee could seize the property itself;... and [they] had the right to immediate possession." Osborne, supra note 19, at 9-10. Title theory states still write mortgages to effectuate an absolute conveyance, but the equity of redemption and other reforms render this a nominal conveyance, regardless of whether the state follows the title theory, lien theory, or a hybrid theory of mortgage law. Id. at 24-25. The basic distinction between title and lien theory states is that the former view title as passing to the mortgagor upon creation of a mortgage in accordance with English common law, while the latter view title as remaining with the mortgagor until foreclosure. Id. See also Real Estate Finance Law, supra note 19, at 10.

24. Real Estate Finance Law, supra note 19, at 7; Osborne, supra note 19, at 12-13; Rudden & Moseley, supra note 19, at 5; see also Shanker, supra note 19, at 73 (noting that prior to the advent of the equity of redemption "freedom of contract was paramount" and the "courts enforced [the agreed upon bargain] literally and precisely").

25. I use the male pronoun throughout this section in order to reflect the historical reality of mortgage borrowing.

26. "Law day" refers to the date of payment and this common law rule was absolute: Failure to pay on law day led to total forfeiture of the property. Real Estate Finance Law, supra note 19, at 7.
Although law courts strictly enforced such terms, courts of equity provided relief to borrowers in circumstances such as those described above, and, over time, in an increasingly broad range of circumstances. Where the borrower failed to pay on time, for reasons ranging initially from mistake to force majeure, and ultimately to tardiness without justification, the borrower's eventual late payment in full "redeemed" his right to the collateral. The equity of redemption exists in every state in the United States. It overrides any contractual language attempting to limit or negate it, such as a waiver or time limit. The equity of redemption is a bright-line limitation on the lender's ability to use the collateral for any purpose other than to recoup the amount lent in the event that the borrower is conclusively unable to pay.

The counterbalance to the borrower's equity of redemption was, and still is, the lender's right of foreclosure. But, over time, laws heavily regulated this lenders' remedy in order to protect the borrower. Today in all but two states, foreclosure requires the lender to go through a public sale to obtain the property.

27. Osborne, supra note 19, at 13.
28. Id.
30. See, e.g., Cowley v. Shields, 60 So. 267, 269 (Ala. 1912) ("There is no merit in the contention that the warranty in the mortgage would preclude the mortgagor or his assignee from redeeming the property; for, if there is such a warranty, it could not operate to cut off the redemption right. Such a warranty or agreement is against public policy."); see also Real Estate Finance Law, supra note 19, at 35 (explaining the clogging doctrine and waiver); Shanker, supra note 19, at 75 (stating that "a mortgagor's equity of redemption could not be made irredeemable").
31. See, e.g., Frazer v. Couthy Land Co., 149 A. 428, 429 (Del. Ch. 1929) (holding that despite a "clause in the [mortgage] agreement . . . whereby the complainant agreed to the time limit of three years as the outside boundary of his right to take the land back . . . a right to redeem continues at all times until it is foreclosed"); see also Real Estate Finance Law, supra note 19, at 35.
32. See Real Estate Finance Law, supra note 19, at 7 (stating that the equity of redemption and right to foreclosure developed concurrently).
33. Eventually, some of these regulations were removed. For example, although foreclosure prototypically required court action, non-judicial foreclosure is now allowed in 60% of jurisdictions. Real Estate Finance Law, supra note 19, at 512.
fee title to the collateral. Moreover, state statutes extensively control the legal steps required to accomplish such a sale. In the forty percent of states that allow only judicial foreclosure, such regulations typically include requirements of adequate notice, a hearing, regulation of the method of sale, and a process for determining rights to any surplus. But even those states allowing nonjudicial foreclosure, most prevalently the power of sale, regulate notice and other aspects of the foreclosure process. Like the equity of redemption, the loan agreement cannot alter these statutory limits on foreclosure. For example, the loan agreement cannot expand the lender's rights with remedies, such as strict foreclosure or a deed in lieu of foreclosure, and cannot limit the borrower's rights in foreclosure, such as by curtailing the notice to the borrower.

35. In title theory jurisdictions, the lender technically retains fee title to the collateral, giving the lender the right of possession, but most title states treat it simply as a security interest. See REAL ESTATE FINANCE LAW, supra note 19, at 130-33. Regardless of the type of jurisdiction, the practical consequences to the borrower and lender are largely the same. See supra note 23.

36. In other words, the remedy of foreclosure is not aimed at giving the lender title to the collateral, but rather at giving the lender proceeds from the sale of the collateral. Burkhart, supra note 19, at 269 (noting "even the title theory states recognize that the lender's paramount right is to repayment of the debt"); see also Shanker, supra note 19, at 76 (explaining the evolution from strict foreclosure to foreclosure by sale).

37. According to Osborne, "The purpose of notice is to inform the public as to the date, place, nature and condition of the property to be sold and terms of the sale. Questions as to the sufficiency and definiteness of notice to accomplish these purposes sometimes are of importance." OSBORNE, supra note 19, at 683.

38. REAL ESTATE FINANCE LAW, supra note 19, at 492.

39. Id. Importantly, however, after foreclosure, it is difficult to overturn a foreclosure sale on grounds such as the inadequacy of the sales price. See id. at 589.

40. Id. at 513; OSBORNE, supra note 19, at 733-36.

41. Both of these remedies are also attempted clogs on the equity of redemption, which mortgage law abhors. See, e.g., First Illinois Nat'l Bank v. Hans, 493 N.E.2d 1171, 1174-75 (Ill. App. Ct. 1986) (refusing to enforce a clause in the mortgage "requir[ing] the mortgagor to execute a deed upon the occurrence of a default" (emphasis omitted)); see also Steven Wechsler, Through the Looking Glass: Foreclosure by Sale As De Facto Strict Foreclosure - An Empirical Study of Mortgage Foreclosure and Subsequent Resale, 70 CORNELL L. REV. 850, 851, 858 (1985) (discussing the relationship between strict foreclosure and the equity of redemption, but arguing, on the basis of empirical evidence, that strict foreclosure should be permitted so long as additional mortgagor protections are in place). While deed in lieu clauses in the original loan agreement are not enforceable, the law does not necessarily prohibit them in subsequent transactions. Accordingly, the parties may later agree to a deed in lieu of foreclosure, though the courts carefully scrutinize such agreements for signs of fraud or oppression. See REAL ESTATE FINANCE LAW, supra note 19, at 43.

42. See, e.g., Fleisher Co. v. Grice, 226 A.2d 153, 155 (Md. 1967) (stating that parties are free to contract beyond the base amount of notice required by the statute but not below). Courts regularly approve of foreclosure proceedings where a reasonable attempt was made to follow the statute, even if strict compliance did not occur. See REPOSSESSIONS AND FORECLOSURES, supra
OVER half of the state legislatures have also added a statutory right of redemption that allows the borrower to redeem the property for a certain period of time after the foreclosure. In addition, by the 1970's, many state legislatures had passed usury laws capping interest rates that could be charged on residential mortgage loans.

Courts have long supplemented these borrower-protective remedies with a range of interventions focusing on contract formation and interpretation, which effectively trump the contract language. A textbook example is that of a contract for an outright conveyance of land that the court determines to be a mortgage transaction on the basis of parol evidence. Often, this rewriting of the contract provides the borrower with the benefit of the equity of redemption, sometimes it limits the interest rates charged, and sometimes it imposes foreclosure rules on the lender.

As these legal rules illustrate, one characteristic of the residential mortgagor is that he is a legal entity worth investing in, including by means of favorable legal rules. Another important characteristic is that he is a legal entity.

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Footnotes:

43. Junior lienors are also often permitted to redeem.

44. This right is in addition to the equity of redemption.

45. See Part II.A.i. Justice Field's majority opinion in Pierce v. Robinson is a typical reaction to parol evidence in the mortgage context:

I consider parol evidence admissible in equity, to show that a deed absolute upon its face was intended as a mortgage, and that the restriction of the evidence to cases of fraud, accident, or mistake, in the creation of the instrument, is unsound in principle and unsupported by authority. The entire doctrine of equity, in respect to mortgages, has its origin in considerations independent of the terms in which the instruments are drawn.

13 Cal. 116, 125 (1859); see also KORNGOLD & GOLDSTEIN, supra note 19, at 356 (stating that "[c]ourts generally favor debtors in their willingness to pierce the facade of the absolute deed and find an equitable mortgage"); Shanker, supra note 19, at 74-75 (stating that the contract could not provide the mortgagee any interest in the mortgagor's property once the loan was repaid in full).

46. See, e.g., Campbell v. Dearborn, 109 Mass. 130 (1872); see also REAL ESTATE FINANCE LAW, supra note 19, at 58 (stating that the right to redeem is a legal consequence of the mortgage's existence); OSBORNE, supra note 19, at 116 (stating that the right to equity of redemption "flow[s] from the existence of the mortgage relation").


susceptible to exploitation because of the borrower's level of power and sophistication as compared to the lender's level. Until the late 20th century, the legal paradigm of the residential mortgagor was that of the ignorant borrower who was unable to protect his interests by means of private ordering and who needed certain non-waivable legal rights and remedies to fully participate in the market for credit, as was necessary for the greater social good.50

The interventions developed during the regulatory phase included and exceeded the typical contract-based interventions, such as fraud, unconscionability, and the Statute of Frauds,51 effectively superimposing property-based rules on the mortgage loan agreement. For example, the borrower does not have to bargain for the equity of redemption or for limitations on deficiency judgments52; these are rights associated with the status of mortgagor.53 Consequently, mortgage transactions, in contrast to the typical non-land-based contract, have historically been the subject of extensive judicial interventions and statutory protections.

While at least partially intact today, this paradigm has degraded over the last twenty-five years as the focus has shifted from exploitation of the borrower towards access to credit.54 The almost unanimous justification given for this deregulation was the need in the late 1970's and early 1980's to rejuvenate mortgage borrowing, which had become stagnant along with the economy.55 Federal preemption of state laws regulating residential mortgage lending and consumer borrowing was perhaps the single greatest instrument of deregulation.56 The most visible state laws to be preempted have been those

50. The particular social goods at issue here are those often associated with private property law, such as its contribution to wealth formation, to the creation of a market in real estate, and to the enhancement of land's alienability. See infra Part III.B.

51. The Statute of Frauds has a property-specific component: All contracts regarding land must be in writing. KORNGOLD & GOLDSTEIN, supra note 19, at 85.

52. See, e.g., Mooney v. Byrne, 57 N.E. 163, 165 (N.Y. 1900) ("The right to redeem is an essential part of a mortgage, read in by the law, if not inserted by the parties."); Scheibe v. Kennedy, 25 N.W. 646, 647 (Wis. 1885) (stating that the same principle applies to the requirement of foreclosure). A mortgagor can bargain for a higher level of protection than the law allows. For example, borrowers can bargain for a fully non-recourse loan; however, the right of redemption and the requirements relating to foreclosure are examples of mortgagor protections on the basis of their status as "ignorant" borrowers.

53. Part I.D. discusses the status-based protections as property rules because they focus on protection of the borrower's ownership of collateral and have many characteristics of typical property rules, as defined by Calabresi and Melamed. See Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 HARV. L. REV. 1089 (1972). In contrast, a contract approach requires the mortgagor to bargain for the right of redemption and for limitations on the right to foreclose.


55. See Mansfield, supra note 20, at 521.

56. Some statutes explicitly preempted state laws, while courts interpreted others as
capping usurious interest rates. Section 85 of the National Bank Act of 1864\textsuperscript{57} authorizes national banks to charge interest at the highest rate charged by any lender in the state in which those national banks are located. State usury laws largely set the standard for permissible interest rates until two events occurred in the late 1970's. In 1978, the Supreme Court held that a national bank can "export" the interest rate permitted in the state in which the bank is "located"\textsuperscript{58} to all states in which the bank's borrowers are located.\textsuperscript{59} Consequently, many national banks located themselves in states such as South Dakota,\textsuperscript{60} which had liberal usury laws, or none at all.\textsuperscript{61} In 1979, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), which explicitly preempted state usury laws.\textsuperscript{62} The Alternative Mortgage

having a preemptive effect. See Schiltz, supra note 7, at 540-69.


58. The term "located" has been heavily litigated. See Schiltz, supra note 7, at 546-60.


60. South Dakota's applicable statute states:

Unless a maximum interest rate or charge is specifically established elsewhere in the code, there is no maximum interest rate or charge, or usury rate restriction between or among persons, corporations, limited liability companies, estates, fiduciaries, associations, or any other entities if they establish the interest rate or charge by written agreement.

S.D. Codified Laws § 54-3-1.1 (2005).

61. Schiltz notes that liberal or non-existent state usury laws "give[ ] states such as South Dakota and Delaware incentive to engage in a 'race to the bottom' of consumer credit regulatory schemes, in order to attract consumer lending operations to their states." Schiltz, supra note 7, at 619. The South Dakota statute and the Marquette decision only apply to national banks. While many mortgage lenders are national banks, many are not. See Mansfield, supra note 20, at 526-27. By contrast, the National Bank Act and the Marquette decision have a broader preemptive effect in credit card lending. However, other federally chartered banks, state chartered banks, and their subsidiaries are also entitled to preemption of some state laws. Given the benefits of preemption to lenders, many other banking entities are finding ways to fall within the cover of the exportation clause. See NATIONAL CONSUMER LAW CENTER, THE COST OF CREDIT 67-69, 73 (2d ed. 2002); Schiltz, supra note 7, at 569-617.

62. Federal law states:

The provisions of the constitution of any State expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved by lenders and the provisions of any State law expressly limiting the rate or amount of interest, discount points, or other charges which may be charged, taken, received, or reserved shall not apply to any loan, mortgage, or advance which is insured under subchapter I or II of this chapter.

Transactions Parity Act of 1982 (AMTPA) was another source of preemption, specifically of state laws requiring fixed interest rates on residential mortgage loans. 63

Concurrent with the deregulatory effects of preemption, changes in tax laws, 64 creation of the secondary market in residential mortgage loans, 65 and massive entry by mortgage brokers and nondepository lenders into the residential mortgage market 66 succeeded in ensuring very broad access to mortgage credit.

Deregulation is often blamed for enabling predatory lending which occurs on a massive scale in the mortgage market today. 67 If contemporaneity is

[hereinafter Reforming Foreclosure] (discussing the history of federal statutes preempting state usury laws).

63. 12 U.S.C. §§ 3803-04 (2000). Some of the new mortgages permitted by the AMTPA have been challenged as clogging the equity of redemption. See REAL ESTATE FINANCE LAW, supra note 19, at 36-38. A third statute, the Garn-St. Germain Depository Institutions Act of 1982, 12 U.S.C. § 1701j-3 (2000), also preempts state mortgage law. That statute makes due-on-sale clauses more uniformly enforceable by lenders. Reforming Foreclosure, supra note 62, at 1413. Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) rulings and letters have extended the reach of these statutes to more entities and to more substantive provisions of the loan agreement, such as penalties for late payment and closing costs. Schiltz, supra note 7, at 535, 561-64, 602. In Smiley v. Citibank, 517 U.S. 735, 747 (1996), the Supreme Court upheld the OCC's significant expansion of the term "interest" in the National Bank Act as reasonable, finding that the OCC has the authority to interpret the definition in the statute it is charged with enforcing.

64. According to Professor Mansfield, the Tax Reform Act of 1986 "disallowed the deductibility of consumer interest but permitted taxpayers to deduct interest paid on loans secured by the taxpayer's principal and one other residence." Mansfield, supra note 20, at 522 (internal citations omitted).

65. Mansfield, supra note 20, at 531-32. The rise of the secondary market was undoubtedly aided by the greater uniformity resulting from preemption. See Reforming Foreclosure, supra note 62, at 1411-13. The holder in due course doctrine also contributed to the protections afforded purchasers of new securities. See THE COST OF CREDIT, supra note 61, at 422-23; Schiltz, supra note 7, at 537-38;

66. Mansfield notes that "[t]his steady growth of finance company participation in real estate lending is significant because these lenders are now the most active group of subprime, nonpurchase money lenders." Mansfield, supra note 20, at 526.

67. See, e.g., THE COST OF CREDIT, supra note 61, at 60-66; Mansfield, supra note 20, at 528-31. In 1993, approximately 100,000 subprime home loans were originated, and by 2002 the number of subprime home loans originated had increased to a staggering 1.36 million. Association of Community Organizations for Reform Now [hereinafter the ACORN Report], Separate and Unequal: Predatory Lending in America 6 (2004), http://www.acorn.org/index.php?id=1994. See Legislative Solutions to Abusive Mortgage Lending Practices: Joint Hearing Before the Subcommittee on Financial Institutions and Consumer Credit, Subcommittee on Housing and Community Opportunity, 109th Cong. at 6-7 (May 24, 2005) (statement of Martin Eakes, C.E.O., Self-Help and the Center for Responsible Lending). One of the major forces driving the subprime market was the massive influx of private capital and investors during the 1990's. "Subprime mortgage-backed securities grew
any indication, the legal counterbalances to the deregulation were the federal Consumer Credit Protection Act of 1968 (CCPA)\(^{68}\) and the Real Estate Settlement Procedures Act of 1974 (RESPA).\(^{69}\) The CCPA regulates disclosure,\(^{70}\) billing,\(^{71}\) debt collection,\(^{72}\) and credit reporting\(^{73}\) practices and addresses lending discrimination,\(^{74}\) providing significant protection to consumer borrowers in all contexts, not just mortgage borrowing. These two statutes also heralded the dawn of a markedly different approach to consumer protection than that developed by mortgage law. The regulatory focus was on the adequacy of the disclosure made to the borrower about the terms of the lending contract, rather than on directly protecting the borrower from loss of collateral.\(^{75}\)

While the deregulatory phase cultivated the current "ownership society" by encouraging broader availability of credit, status-based protections are not things of the past in mortgage law. Status still has a powerful influence over lawmakers.\(^{76}\) None of the new statutes override the equity or the statutory right of redemption,\(^{77}\) leaving intact one of the greatest protections for borrowers.

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75. Part III.A. discusses how the disclosure regime prevalent in credit card lending has begun to infect mortgage lending as well. See infra Part III.A.
76. Many protections are only available to the borrower who ends up in court before the lender begins a foreclosure action, particularly in states which permit non-judicial foreclosure. As predatory lending vividly demonstrates, much of the exploitation of consumer borrowers can only be remedied by a lawsuit, and many borrowers lack the resources to go to court. In other words, if a borrower does not contest the terms of an onerous mortgage arrangement in court, she may never have the benefit of some of the most potent protections available. This barrier is the basis of legitimate critique by consumer advocates.
77. Some scholars have argued that there have been inroads on the equity of redemption. See, e.g., John C. Murray, Clogging Revisited, 33 REAL PROP. PROB. & TRUST J. 279 (1998); Shanker, supra note 19, at 78-80 (arguing that the Uniform Land Security Interest Act, ULSIA, § 211, 7A U.L.A. 403 (1985), and the American Law Institute’s 1997 Restatement of Mortgage law “expressly authorize the mortgagee in the mortgage contract to validly bargain for an interest in the mortgagor’s property, in addition to their rights to collect the full underlying debt” (emphasis added)); Lou J. Viverito, Comment, The Shared Appreciation Mortgage: A Clog on the Equity of Redemption?, 15 J. MARSHALL L. REV. 131 (1982). In addition, some worry that the Ney-Kanjorski bill, which seeks to limit predatory lending, is broad enough to preempt the equity of redemption and any other state consumer protection laws. See, e.g.,
Although significantly less regulated than judicial foreclosure, remedies such as the power of sale are still regulated by state statutes, which cannot be waived or limited by contract.\(^7\) Regarding contract formation, state courts continue to void or rewrite onerous clauses and whole contracts to provide greater protections to the borrower.\(^8\) Whether purposeful or not, the current law of mortgage lending enshrines a series of balances between broad access to credit and protection of the borrower’s status as owner of the collateral,\(^8\) between federal and state regulation, and between property-protective contract reinterpretation and opportunities for private ordering.\(^8\)1

Margot Saunders & Alys Cohen, NCLC Response to Dear Colleague Letter Supporting H.R. 1295, (Apr. 19, 2005), http://www.consumerlaw.org/initiatives/predatory_mortgage/content/responsetodearcolleague.pdf (critiquing the Ney-Kanjorski bill). Finally, some might argue that OCC regulations such as 12 C.F.R. § 34.4 could be broadly interpreted to preempt the equity of redemption and other state law protections for the borrower.

Notice requirements, for example, are less strict for power of sale foreclosures than for judicial foreclosures. REAL ESTATE FINANCE LAW, supra note 19, at 582. Courts have held, however, that failure to give proper notice for power of sale foreclosures may render the sale void. See REPOSSESSIONS AND FORECLOSURES, supra note 29, at 512.


The problem of predatory lending in the mortgage market demonstrates that these legal measures, while important, are insufficient to adequately protect borrowers from lender exploitation. Even the CCPA, with its focus on adequate disclosures to borrowers, has diluted mortgage law’s emphasis on the borrower’s status as a basis for substantive protections. It is reasonable to wonder whether a status-based strategy would result in more effective protections for borrowers against predatory lenders. Professors Engel and McCoy’s suitability proposal, which requires the creditor to assess the suitability of the loan for the borrower prior to making the loan, might be an example of such protection. See Kathleen C. Engel & Patricia A. McCoy, A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 TEX. L. REV. 1255, 1317-1366 (2002) [hereinafter A Tale of Three Markets].

I join the many consumer advocates who argue that this series of balances is insufficient, given the rampant exploitation that occurs in the subprime mortgage market. Nonetheless, in contrast to the credit card market, the mainstream or prime mortgage market does, at some level, maintain the balances described above.

Karen M. Pence suggests in her empirical study that state borrower-protective foreclosure laws benefit defaulting borrowers to the detriment of non-defaulting borrowers. See Karen M. Pence, Foreclosing on Opportunity: State Laws and Mortgage Credit 28 (2003), http://www.federalreserve.gov/pubs/feds/2003/200316/200316pap.pdf. As federal law preempts some state borrower protections, they maintain broad access to credit, while state laws that are not preempted continue to protect defaulting borrowers. Although the combined effect of these
B. Credit Cards: The Enlightened Borrower

Such balance is not evident in credit card lending. Although exploitation of credit card borrowers is rampant and rising, the credit card market continues to experience a deregulatory trend. Laws that regulate credit card lending have always used a markedly different approach from traditional mortgage law. The prevailing theme in the law of credit card lending is not one of contract reinterpretation to aid borrowers.

Instead, credit card law regulates disclosure. This approach originated with the CCPA, the "all-purpose" consumer credit statute enacted in 1968. The Truth In Lending Act (TILA), whose purpose is "to assure a meaningful disclosure of credit terms" and "to protect the consumer against inaccurate and unfair credit billing and credit card practices," is the most obvious manifestation of this new regime. TILA accomplishes this purpose by focusing on the disclosure of the terms and costs of the loan—namely of finance charges and annual percentage rates—and by regulating advertising. Generally, as long as lenders do not deceptively state the terms of the loan, the law will not curb the terms' substantive harshness.

The amended TILA does have special protections for credit card borrowers. Although these protections have been described as more

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laws may not be sufficient to counteract predatory lending, it does suggest a balance between access and exploitation.

82. The CCPA applies to all forms of consumer credit and generally does not distinguish between credit cards and mortgages. It does regularly distinguish between closed-end credit, where a fixed amount typically is loaned up-front, and open-end credit, where the borrower borrows money in frequent, often irregular transactions, and amounts which are merged into a single outstanding amount of debt. See THE COST OF CREDIT, supra note 61, at 51. Unlike most mortgages which are closed-end lending arrangements, credit card lending typically is open-end financing, where the amount financed depends on the amount purchased per month and not repaid fully at the end of the month. See Bar-Gill, supra note 5, at 1395-96.

83. 15 U.S.C. § 1601 (2000). At least one commentator has described TILA as the "centerpiece" of the CCPA. Shiltz, supra note 7, at 533.


86. The only real limitation that TILA imposes on the substantive terms of the contract is the right of rescission, which is available only to consumers entering into non-purchase money mortgages on their homes and only for three days if the creditor has followed the statutory disclosure requirements; if the consumer does not receive the required disclosures, the right of rescission can last three years. Id. § 1635. See generally MARY DEE PRIDGEN, CONSUMER CREDIT AND THE LAW § 15:16-19, 20-21 (2004); ROHNER & MILLER, supra note 4, at 683; Deborah Freye et al., Truth in Lending Developments, 59 BUS. LAW 1125, 1130 (2004); Brian P. Richards, The Right of Rescission: A Continuing Concern for Mortgage Lenders, 111 BANKING L.J. 557 (1994). Thus, one of the few substantive provisions of TILA that has the effect of limiting contract terms, is available only to mortgage borrowers.

substantive,⁸⁸ they are actually little more than specific remedies for inadequate disclosure and for failure of contract formation at the most basic level, more akin to an unconscionability defense than to the substantive property rules of traditional mortgage law. A 1970 amendment, for example, prohibits unsolicited issuance of credit cards, an attempt to ensure that a meeting of the minds occurred in the contract formation process and to protect consumers from third party fraud, which the creditor is in a better position to prevent.⁹⁹ A second amendment limits consumers’ liability for unauthorized use of their credit cards.⁹⁰ While this provision overrides any contract language to the contrary, it, too, is a protection against the most fraudulent type of activity, which, although not perpetrated by the creditor, is more easily prevented by the creditor than the borrower.⁹¹ These protections are significantly less borrower-protective than the limitations on creditors’ remedies and contract reinterpretation that have been the norm in mortgage law.

TILA’s disclosure regime assumes it deals with a markedly different type of borrower than mortgage law’s borrower. Most importantly, it assumes that once a borrower is properly informed of the credit terms proposed by the lender, such as the actual interest rate charged, the borrower will have enough sophistication and bargaining power to negotiate loan terms that are reasonably favorable. Also implicit in the non-mortgage-specific provisions of this statute is an assumption that the borrower is not risking very much because there is no home or other collateral at stake. In contrast to the traditional mortgage borrower, the TILA borrower needs very few rights that are non-waivable by contract. It is only when the lender is in a position to avoid the risk that the statute overrides traditional contract rights and remedies in favor of the borrower. In other words, in contrast to the ignorant borrower of traditional mortgage law, the prototypical borrower assumed by the TILA regime is enlightened.

While not explicitly focused on disclosure, the other pieces of the CCPA assume the same borrower paradigm as TILA. The Fair Credit Reporting Act (FCRA), for example, administers a system requiring credit bureaus to maintain and disseminate to certain types of creditors⁹² accurate credit reports on individuals, which the credit bureaus must also disclose to those individuals upon request.⁹³ The FCRA does not regulate the ways in which a lender can

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⁸⁸ ROHNER & MILLER, supra note 4, at 685-87.
⁹¹ Other protections for credit card borrowers include the requirement that credit card companies post payments on the day received under the TILA and greater rights in the billing context under the Fair Credit Billing Act. For analyses of these protections, see CONSUMER CREDIT LAW MANUAL, supra note 8, at § 15.
⁹² FCRA also applies to certain other entities, such as employers. 15 U.S.C. § 1681(b) (2000).
use the credit report. Meanwhile, the Fair Debt Collection Practices Act operates at the margin of private ordering by regulating collection practices, usually in the nature of tortious, unfair, or harassing behavior, that the borrower and lender may not have negotiated by contract. While arguably more substantive than TILA, these statutes leave much of the loan contract fully intact, including onerous penalty clauses.

Three other factors increase the dominance of the disclosure regime established by TILA in the context of credit card borrowing. Like most of TILA, these regulations do not isolate credit cards for special treatment; however, consumers feel their impact most widely in the context of credit card borrowing. Importantly, none of these developments were driven by attention to the needs of, and risks borne by, credit card borrowers. For example, nowhere does the law appear to consider whether onerous penalty clauses limit

94. This is in contrast to FCRA's arguably more substantive regulation of an employer's use of credit reports, which includes requirements to disclose to the employee or potential employee her statutory rights and to obtain the employee's release signature before the employer can acquire the credit report. 15 U.S.C. § 1681(b) (2000). More broadly, the statute restricts the type of information that can appear on a consumer's credit report, such as certain medical information, and requires that those providing the information to creditors maintain accuracy and update a consumer's report when inaccuracies are known. 15 U.S.C. § 1681c (2000). The latter requirements, while not limiting lenders' behavior, could also be seen as substantive restrictions on lending.

95. 15 U.S.C. § 1692 (2000). The same could be said about the Equal Credit Opportunity Act, which regulates against discrimination. 15 U.S.C. §§ 1691-1691f (2000). As I define substantive intervention, the Fair Credit Billing Act is the most interventionist, and thus the most similar to traditional mortgage law, in that it overrides contract language concerning procedures for accurate billing. 15 U.S.C. § 1666 (2000). For example, § 1666b regulates the circumstances under which finance charges can be imposed on open-end credit accounts, regardless of the terms of the contract between the borrower and creditor. Similarly, § 1666 sets forth the procedure for correcting billing errors, regardless of whether private bargaining allows the creditor to do less. See also 12 C.F.R. § 226.

96. I am not claiming here that the CCPA is not an important consumer protection statute or that it is ineffective. Rather, my claim is that the CCPA implicitly assumes a different kind of borrower than that protected by mortgage law.

97. The FTC Credit Practices Rules, 16 C.F.R. §§ 444.1 to 444.5, provide some protections that arguably override private bargaining. For example, § 444.2 prohibits lenders from requiring consumer borrowers to sign a confession of judgment, a waiver of limitation of exemption from attachment such as a homestead exemption, an assignment of wages, or convey a "nonpossessory security interest in household goods other than a purchase money security interest." 16 C.F.R. § 444.2(a)(4) (2000). Section 444.4 limits late charges "on a payment, which payment is otherwise a full payment for the applicable period and is paid on its due date or within an applicable grace period, when the only delinquency is attributable to late fee(s) or delinquency charge(s) assessed on earlier installment(s)." 16 C.F.R. § 444.4(a) (2000). While these protections are helpful, they minimally protect against the most egregious and unconscionable behavior, which would likely be unfair trade practices under state statutes or common law.
credit card borrowing, whether they result in too much exploitation, or how they generally affect borrower behavior.

The first contributing factor is the kind of preemption that has been taking place in the mortgage market for the past three decades. While the DIDMCA's primary impact is on mortgages, and the AMTPA applies only to mortgage loans, the preemptive effect of § 85 of the National Bank Act, as interpreted by the Supreme Court in Marquette, applies equally to credit card borrowing. Indeed, the loan transaction in Marquette was an open-end credit card transaction. The second factor intensifies the effect of § 85 on the rights of credit card borrowers. Major credit card issuers are national depository institutions or their subsidiaries and have benefited from significant deregulation of their practices in the past few decades. To counterbalance the regulatory impositions on national banks, the Supreme Court, Congress, and the agencies responsible for regulating national banks have bestowed upon them rights equal to state banks' privileges in important substantive areas.

98. 12 U.S.C. § 1735f-7a (2000) (preempting all state usury laws imposed on loans secured by first mortgages on residential real estate). Thanks to the exportation doctrine, however, the DIDMCA's preemptive effect shields federally insured credit card lenders. See THE COST OF CREDIT, supra note 61, at 70-71.


101. Id. at 302 n.4.

102. One commentator writes:

[T]he most distinguishing feature of the credit card industry is its recent concentration.... Today, the top ten card issuers control nearly 77 percent of the card market and 69 percent of the $1.2 trillion in 1999 charge volume.... Indeed, industry mergers and acquisitions have reduced the number of major corporate players and thus contributed to the costly increase in consumer banking services in general... and credit card finance charges and fees in particular.

MANNING, supra note 4, at 95.


104. For a detailed discussion of the regulatory efforts to equalize competition between state and federally chartered banks, see Schiltz, supra note 7, at 540-56.
The "exportation doctrine" developed in *Marquette* is a primary example. It has been continually expanded by federal courts, the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) to include a broad range of lenders and to limit the effect of state consumer protection laws regulating penalties, terms of credit, and disclosure.

Because usury caps were among the few state laws imposing substantive limitations on credit cards, their preemption allowed much greater exploitation by credit card issuers. The result, according to one empirical study, was the rapid expansion of the credit card industry, eighty percent of whose profits derive from interest payments. By eliminating the major substantive limitations on credit card lenders, the law certainly increased availability of credit to a broader range of borrowers. As credit card borrowers incurred vast amounts of debt, comparable only to mortgage debt, the law also left them with very few substantive rights other than the right to information.

As Part II.A. describes, courts have been extraordinarily reluctant to void or reinterpret credit card contracts in favor of borrowers. In marked contrast to the mortgage lending context, courts have upheld arbitration clauses, penalty

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105. *Id.* at 546-47.

106. *Id.* at 535, 561-65, 602; *see supra* note 60.


109. Am. Bankers Ass'n v. Lockyer, 239 F. Supp. 2d 1000, 1013-14 (E.D. Cal. 2002) (accepting the argument made by plaintiffs and OCC as amicus curiae that § 85 preempted a California statute imposing disclosure requirements on credit card lenders that were more stringent than TILA).

110. *SULLIVAN ET AL., supra* note 5, at 135 (also noting that the remaining 20% of profits come from "annual fees, late fees, over-limit fees, and merchant fees"). *See also* Lawrence M. Ausubel, *Credit Card Defaults, Credit Car Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249 (1997).

111. Professors Sullivan, Warren and Westbrook state: "The enormous profits available from people who charge up to the limits and pay only the minimum each month have made delinquent card holders who pay high interest the most valued customers in the business. . . . The credit card companies hope to expand credit card debt even further. . . . Their most aggressive targeting is aimed at the only group left that is not already inundated with plastic: the poor." *Id.* at 135-36.

clauses, and onerous pricing terms, on grounds of preemption and in the face of compelling parol evidence that such terms were inappropriately imposed. In so doing, courts have established that the only meaningful backstops to exploitative lender behavior, other than the disclosure regime of the CCPA, are traditional contract defenses, such as unconscionability, fraud, and bad faith.

While mortgage lenders today are subject to the equity of redemption, limitations on foreclosure and other penalties, judicial scrutiny of contract formation and interpretation, and, depending on the type of lending institution, some usury caps, credit card lenders are subject to very few consumer protection regulations other than the CCPA. While the disclosure regime of the CCPA supplements the more substantive property protections provided by traditional mortgage law to residential mortgage borrowers, credit card borrowers must rely extensively on disclosure for protection.

C. Homestead and Other Exemptions and Bankruptcy

There are two important exceptions to the disclosure-only regime in credit card borrowing. While powerful, however, these protections do not ultimately neutralize the important differences between the two legal regimes for consumer borrowers.

The first group of protections are state homestead and personal property exemptions, which exempt certain items from seizure by judgment creditors. In some states, these laws generously define the necessities of life, leaving a relatively broad range of individual debtors judgment-proof. If a credit card or other unsecured lender wins a judgment against a borrower, that lender may nonetheless be unable to collect. A mortgagee, on the other hand, is a secured creditor who can collect the debt owed by foreclosing on the collateral. Such a remedy does not exempt the borrower's house when it is used as collateral.

(Del. Super. Ct. 2001). The vast majority of reported cases in which consumers have challenged specific clauses of credit card contracts have avoided consideration of such claims on the grounds that a valid arbitration clause precluded such consideration.

113. See, e.g., Morris v. Redwood Empire Bancorp, 27 Cal. Rptr. 3d 797, 809 (Cal. Ct. App. 2005) (holding that $150 fee charged by credit card company to terminate a “merchant account” that had been opened by an elderly disabled man with a home-based small business was not unconscionable). This appears to be one of the few cases not dismissed on grounds of preemption or an applicable arbitration clause.

114. But see infra Part I.C.

115. But see supra note 61 regarding the expansion of the exportation doctrine to cover a broader range of lenders.

116. For an overview of exemption law, see CONSUMER CREDIT LAW MANUAL, supra note 8, § 9; NATIONAL CONSUMER LAW CENTER, FAIR DEBT COLLECTION § 12 (5th ed. 2004) [hereinafter FAIR DEBT COLLECTION].

117. See FAIR DEBT COLLECTION, supra note 116, Appendix F, at 751-78.

118. Limitations on attachment of wages and bank accounts also protect borrowers. See CONSUMER CREDIT LAW MANUAL, supra note 8, § 9.
collateral, no matter how much of a necessity that house is. If none of the legal protections described above prevent foreclosure by the mortgagee, a mortgagor will ultimately lose her home. In other words, while the credit card borrower may have fewer protections on the front end (before she is adjudicated to be in default), she does have a significant protection at the point of loss of personal assets.

The second important consumer protection is bankruptcy. Bankruptcy law provides special protections to residential mortgagees. Specifically, debtors filing for bankruptcy under Chapter 13 are limited in their ability to modify debt secured by the "debtor's principal residence," thereby advantaging residential mortgagees over other secured creditors. This legal benefit for mortgage lenders has, until recently, counseled in favor of incurring credit card debt, which could be fully discharged over residential mortgage debt, which could not even be substantially modified, where bankruptcy is a serious possibility. The new Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has changed this picture. This statute makes it more difficult for consumers to discharge credit card debt, thereby putting credit card lenders on more equal footing with mortgage lenders. Under the new bankruptcy law, credit card borrowers may no longer benefit from as much protection as they once had.

While important, these two major protections occur late in the process of a typical credit dispute. It may be true that a credit card borrower who has lost her day in court will be less likely to lose her home than a mortgagor who has lost her day in court. But it also appears true that a credit card borrower is much more likely to lose her day in court than is a mortgagor. Moreover, these two protections are only available at the point of catastrophe, and homestead and other exemptions are most effective for the poorest borrowers. While progressive in important respects, these protections are far from satisfactory for the average middle-class consumer. Certainly, they do not replace the diffuse borrower sensitivity existing in mortgage law even today.

119. Mortgagees are typically excluded from homestead exemptions. See FAIR DEBT COLLECTION, supra note 116, at 508. In Florida, which exempts a homestead of up to 160 acres, an individual would be well-advised to borrow on something other than her house. By choosing credit card over home equity debt, for example, she would be able to exempt her home from attachment by credit card lenders, while not having to worry about foreclosure by a mortgagee.

120. 11 U.S.C § 1322(b)(2) (2000).


124. Here, I am referring to the mortgagor's day in court prior to a foreclosure proceeding.
D. Two Paradigms, Side by Side

By their very nature, the status-based substantive protections developed during the regulatory phase of mortgage law had the purpose of protecting the borrower's right to his collateral. It is not surprising, then, that these protections are quintessential property rules. They operate much like a specific performance remedy by keeping the collateral in the borrower's hands rather than providing a monetary substitute.\textsuperscript{125} They form a superstructure over the private bargaining of the lender and borrower and are inherently local in nature because their focus is property in a particular geographic location. Moreover, a notable number of rules in the mortgage context are typically non-waivable.\textsuperscript{126}

The absence of land from the credit card transaction might have made the borrowers' protections developed by mortgage law a counter-intuitive model for credit card law. After all, what use would an equity of redemption be to a credit card borrower? Added to the absence of collateral was the nationalization of the banking industry, a phenomenon which deregulation facilitated, at the very moment of the credit card's ascendance. Whether for these reasons or others, the model of regulation that was chosen was contract-based, where parties are free to bargain for rights, remedies are awarded in the form of damages, and the backstops to exploitation are the limited defenses of unconscionability and fraud.

In this respect, however, legal and consumer perspectives diverge. For the borrower, the choice between borrowing regimes is not so dramatic. Credit limits on credit card accounts can be as high as home equity loans.\textsuperscript{127} Teaser interest rates on credit cards can be as low as or lower than interest rates on

\begin{itemize}
\item \textsuperscript{125} This is the classic definition of a property rule, as discussed by Calabresi and Melamed in the context of nuisance law. In their words, "No one can take the entitlement to private property from the holder unless the holder sells it willingly and at the price at which he subjectively values the property." Calabresi & Melamed, supra note 53, at 1105. Their definition of a liability rule is one where "an external, objective standard of value is used to facilitate the transfer of the entitlement from the holder . . . ." Id. at 1106.

\item \textsuperscript{126} The inalienable nature of some rules puts them in a third category described by Calabresi and Melamed, that of inalienability rules: "[T]he law not only decides who is to own something and what price is to be paid for it if it is taken or destroyed, but also regulates its sale—by, for example, prescribing preconditions for a valid sale or forbidding a sale altogether." Calabresi & Melamed, supra note 53, at 1111. For purposes of my comparison of property and contract rules, the non-waivability of these rules makes them more propertarian in nature.

\item \textsuperscript{127} Consider these advertisements from major credit card companies: MBNA, http://www.mbnacom/loans/term_line.html (last visited Sept. 12, 2006) (advertising a card with a credit line up to $25,000 “to use for virtually any large purchase - build a pool, buy a computer, upgrade your home appliances, and more,” for which no collateral is required); Discover Credit Cards, http://www.crediitcards.com/Discover.php (last visited Nov. 14, 2005) (advertising a platinum card with up to a $50,000 credit limit); Advanta Cards, http://www.creditcards.com/products/credit_cards/advanta.jsp (last visited Sept. 12, 2006) (advertising a platinum rewards card with a “large credit limit”).
\end{itemize}
home equity loans. Either form of loan can be closed-end or open-end. Middle class and lower income individuals typically have easy access to both types of loans and regularly use both forms of borrowing to make ends meet.

Despite the different protections available to secured and unsecured creditors, the losses to consumers can be equally devastating in either regime. The credit card creditor must obtain a judgment in order to acquire a lien. For the borrower, however, the consequences, namely loss of physical assets, could be quite similar.

Moreover, the substantive protections developed during the regulatory phase of mortgage law do not exclusively protect the borrower's right to his collateral. As this section and the next show, these protections have produced a more equal loan transaction. For example, the equity of redemption overrides strict time limits on payment. Foreclosure typically provides meaningful notice to the borrower of loss of rights, and courts regularly void onerous loan terms as antithetical to the borrower's intentions. Thus, the average middle-class mortgage borrower today typically has better loan terms than the average middle-class credit card borrower.

II. THE CONSEQUENCES

Part I suggests that the creation of a lending structure ungrounded in real assets has far-reaching consequences for the consumer borrower. The remainder of this Article explores these consequences.

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128. For example, see Wells Fargo, http://www.wellsfargo.com/credit_cards/select_card/ (last visited Sept. 12, 2006) (offering cards with introductory rates as low as 0%); Low Interest Cards, http://www.creditcards.com/low-interest.php (last visited Nov. 11, 2005) (offering cards with introductory rates of 0% from various credit card companies); CitiBank Cards, http://www.credit.com/products/credit_cards/citi.jsp (last visited Sept. 12, 2006) (offering a card for college students with an introductory rate of 0%); Chase Cards, http://www.credit.com/products/credit_cards/chase.jsp (last visited Nov. 11, 2005) (offering a card for students with an introductory rate of 0%); Discover Credit Cards, http://www.credit.com/products/credit_cards/discover.jsp (last visited Sept. 12, 2006) (offering cards with introductory rates as low as 0%, including for college students).

129. ROHNER & MILLER, supra note 4, at 245-48; THE COST OF CREDIT, supra note 61, at 366-69.

130. See supra note 14 and accompanying text.

131. It is unquestionably true that federal tax policy, namely the deductability of mortgage interest, and other factors make residential mortgage lending arguably more attractive. See generally Forrester, supra note 13. These factors are often counterbalanced by the ease and seductiveness of credit card borrowing. See generally Bar-Gill, supra note 5.

132. See supra Part I.C.

133. But see supra Part I.C.

134. I am not referring here to predatory mortgage lending, where loan terms are much more onerous. See infra Part II.B. for a discussion of predatory lending.
A. In Court

This section closely examines the significantly different judicial treatment of the two types of borrowers, detailing the ways in which courts have shaped the two paradigms and demonstrating more fully that a borrower's choice of borrowing regime profoundly impacts her legal rights and protections. As the cases in this section demonstrate, a borrower's day in court is a cumulative result of the prototype by which she is defined. These cases\(^{135}\) represent the norm rather than the exception.\(^{136}\)

1. Mortgages

In *McGill v. Biggs*, Plaintiff John McGill wanted to provide a proper funeral for his mother.\(^{137}\) After unsuccessfully trying to obtain a $1,500 bank loan, presumably unsecured, he turned to his half-uncle, Defendant Johnny Biggs, for help.\(^{138}\) According to Plaintiff, Biggs agreed to give him the funds in return for "collateral" in the form of a quit-claim deed in a house which Plaintiff had jointly owned with his mother.\(^{139}\) Plaintiff made one payment to Biggs but then made no other payments for more than two years, at which point he offered to repay Biggs in full, an offer which Biggs refused.\(^{140}\) Six months later, Biggs recorded the deed and tried to list it with a broker as a rental property.\(^{131}\) Plaintiff sued, claiming that he was the owner of the house, and that the deed merely evidenced a mortgage agreement.\(^{142}\) Despite the recorded deed in favor of Defendant and the apparent absence of any other writing evidencing a mortgage agreement, both the trial court and appellate court ruled in Plaintiff's favor, effectively rejecting the proposition that a contract for conveyance was ever formed.\(^{143}\) They did so in the absence of a finding of

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\(^{135}\) The mortgage case is cited in a well-known treatise, as well as in the Restatement. See *Real Estate Finance Law*, supra note 19, at 57-58; *Restatement (Third) of Property (Mortgages)* §§ 3.2 (1997). The credit card case is among the cases listed by one author as characteristic of courts' treatment of cases with similar facts. Bar-Gill, supra note 5, at 1424 n.213.

\(^{136}\) The mortgage case is not representative of what happens in a foreclosure proceeding. Once a borrower is that far along in the post-default process, courts appear less inclined to reinterpret the mortgage agreement in favor of the borrower and less inclined to overturn the foreclosure sale in favor of protecting the borrower. See supra note 39.


\(^{138}\) Id.

\(^{139}\) Id. Plaintiff was the surviving joint tenant in the house. Id. at 772-73. Because many mortgages today have language providing fee title in the collateral to the lender, McGill's assumption that he was only providing collateral for a loan was not completely unfounded.

\(^{140}\) Id. at 773.

\(^{141}\) Id.

\(^{142}\) Id.

\(^{143}\) Id. at 775. Many courts have held that a deed, though signed by only the grantor, has the effect of a signed contract, thereby typically deserving application of the parol evidence rule
either fraud or unconscionability and apparently without heed to the Statute of Frauds or the Parol Evidence Rule.

What could have justified such a surprising result? An Illinois statute provided that a "deed conveying real estate, which shall appear to have been intended only as a security . . . shall be considered as a mortgage."\(^{144}\) According to Illinois case law, such a determination can be made on the basis of "almost every conceivable fact that could legitimately aid" it.\(^{145}\) In this case, the court considered the facts that McGill owed Biggs money and that both parties believed that the debt remained unpaid, that he had been unable to obtain funds from other sources, that the parties were in a close relationship, that McGill was not represented by an attorney in the transaction, that he continued to treat the house as his own, that he did not intend to sell the house to Biggs, and that there was a large disparity between the loan amount and the value of the house.\(^{146}\) Both the trial and appellate courts considered the context of the transaction.

Although the appellate opinion did not describe it as such, the McGill holding effectively restored the equity of redemption to Plaintiff. While cases interpreting conveyances as mortgages are the most dramatic, such contextual treatment by courts is the rule in mortgage transactions.\(^{147}\) Courts have repeatedly voided remedies, such as strict foreclosure, options to purchase, and deeds in lieu of foreclosure, in order to protect the equity of redemption.\(^{148}\)

and other contract doctrines. See, e.g., In re Weitzel's Estate, 280 N.W. 270, 272 (Neb. 1938) ("In so far as a deed is deemed to be contractual, it is subject to the parol evidence rule the same as any other contract." (quoting 4 Neb. L. Bull. § 11, 134 (1926))); Rael v. Cisneros, 487 P.2d 133, 136 (N.M. 1971) (a deed is "a specialized form of contract"); Radspinner v. Charlesworth, 369 N.W.2d 109, 112 (N.D. 1985) ("A deed is a written contract, and is subject to the [parol evidence] rule."); John Deere Industr. Equip. Co. v. Gentile, 459 N.E.2d 611, 614 (Ohio Ct. App. 1983) ("The parol evidence rule excludes evidence of prior or contemporaneous statements contradicting or varying the terms of a written deed or contract, which is complete and unambiguous on its face."). The recording of a deed raises its utility as evidence of ownership to an even higher level. See generally Corwin W. Johnson, Purpose and Scope of Recording Statutes, 47 Iowa L. Rev. 231 (1962).


145. McGill, 434 N.E.2d at 773. Illinois courts have developed a list of circumstances extrinsic to the deed that ought to be considered, many of which the court did consider in this case. Id. at 774.

146. Id. at 773-75.

147. The Restatement of Mortgages has institutionalized this doctrine. Restatement (Third) of Prop.: Mortgages §§ 3.2, 3.3 (1997).

State statutes regularly supplement case law by, among other things, limiting late fees that can be charged to protect the debtor's ownership rights. In this case, McGill's testimony that he did not understand what a "quit-claim" deed was, that he thought he was signing something he was not, and that he did not have an attorney were all facts supporting the voiding of the contract. In this respect, the court's language and imagery are quite telling. The court variously described the borrower as "vague as to the nature of the transaction," "upset and distressed when the transaction took place," and "falling on hard times by drinking heavily." It noted that the "disparity of the situations of the parties" was one circumstance to be considered in determining whether the transaction was in fact a mortgage.

2. Credit Cards

In *Arriaga v. Cross Country Bank*, Plaintiff Andrea Arriaga responded to a promotional mailing from Defendant Cross Country Bank (CCB) by submitting an application for a CCB credit card. In her class action lawsuit against CCB in federal district court, Arriaga claimed that before she received her credit card, she was charged "$150 in up-front fees," which CCB had not disclosed to her. Shortly after she received her credit card, CCB charged her for an "Applied Advantage" membership, which she had neither known about nor requested. Plaintiff's theory was that these charges were part of a fraudulent scheme by CCB to force customers over their credit limits, thereby

Barr v. Granahan, 38 N.W.2d 705, 708 (Wis. 1949) (determining "that the purpose of the option agreement was to secure the mortgage indebtedness"); see also John C. Murray, *Clogging Revisited*, 33 REAL PROP. PROB. & TR. J. 279 (1998) (discussing deeds-in-lieu of foreclosure as clogs on the equity of redemption).

149. REAL ESTATE FINANCE LAW, *supra* note 19, at 449-50. Note, however, that some of these statutes are preempted by the National Bank Act and OTS regulations. *Id.* at 451.

150. McGill, 434 N.E.2d at 773.

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.* at 774.


156. Plaintiff also named Applied Card Systems, Inc., which promoted the Applied Advantage program on behalf of CCB. *Id.* For simplicity's sake, I will refer to both as the defendant.

157. *Id.*

158. *Id.*

159. *Id.* at 1190-91. She also claimed that CCB "purposefully failed to send monthly billing statements, forcing her and other customers to request one at a charge of $3 to their credit accounts." *Id.* at 1191.
causing them to incur "over limit" fees. She claimed violations of TILA, California deceptive trade practices and unfair competition statutes, fraud, and breach of contract.

On an abstract level, the facts of the Arriaga and McGill cases are comparable. Both involve consumer debt, with a lender more sophisticated than the borrower. Both have suggestions of fraudulent behavior, in which the plaintiff believed he or she was entering into a transaction that the lender defined differently. Moreover, the facts of Arriaga are arguably more egregious than McGill. In McGill, for example, Plaintiff had failed for more than two years to make any payments to Defendant for the alleged loan, while in Arriaga, there was no evidence of late payment or any other default by Plaintiff. A key difference in the cases' facts is that McGill's loan was secured by a house.

But both the results and the analyses of the two cases were so different that it seems almost illogical to compare them. While the McGill court considered the broad context surrounding the transaction in order to grant Plaintiff relief, the Arriaga court kept strictly to the terms of the credit card contract. In doing so, it rejected Arriaga's arguments for voiding the arbitration clause in Arriaga's credit card contract and instead granted Defendant's motion to compel arbitration. Arriaga's argument that the clause had been obtained by fraudulent inducement and was, therefore, unconscionable was among the most persuasive. Arriaga contended that she was "forced to agree" with the arbitration clause and with the credit card agreement as a whole because CCB had already charged her account by the time it sent her the credit card agreement. Thus, Arriaga would have risked incurring a negative credit report by contesting the terms of the agreement. The court, however, refused to consider these facts because Supreme Court precedent limited it only to deciding whether the arbitration clause, independent of the remainder of the

160. Id. at 1191.
161. Id. at 1190.
162. Id.; McGill, 434 NE.2d at 772-73.
164. Id. at 774-75.
165. Arriaga, 163 F. Supp. 2d at 1191.
166. In some of her arguments, plaintiff asked the court not to apply the arbitration clause to some of her claims, rather than void it altogether. Id.
167. The court granted this motion and stayed the court proceeding pending arbitration. Id. at 1202.
168. Id. at 1193.
169. Id. The court also rejected her argument that some of her claims arose before she had entered into the credit card agreement with the arbitration clause on the grounds that the language of the arbitration clause covered all claims that "relate to or arise out of" the credit card agreement. Id. at 1192 (quoting Arriaga's credit card agreement) (emphasis omitted).
170. Id. at 1193.
contract, was fraudulently obtained or unconscionable.\textsuperscript{172} The court did this despite the Federal Arbitration Act's broad statement that an arbitration clause shall be valid "save upon such grounds as exist in law or in equity for the revocation of any contract."\textsuperscript{173} Regarding the facts related to the arbitration clause, the court held that none of these were so egregious as to be fraudulent or unconscionable.\textsuperscript{174} The court found that Arriaga was enlightened enough to understand the terms that she was accepting in the agreement and to understand that she could opt out of them.\textsuperscript{175} Here, too, the court's language and imagery are telling. In denying Arriaga's challenge to the arbitration clause as unconscionable, the court stated that the terms were not "beyond a reasonable persons [sic] expectations,"\textsuperscript{176} in part because the contract "clearly states the [National Arbitration Forum's] toll-free number and world wide web address from which Arriaga could have obtained the full terms and rules in question."\textsuperscript{177}

Could this case have looked more like McGill if the court had not interpreted precedent to require such a narrow review of only that clause rather than the whole contract or if there had been no arbitration clause at all? One way to answer this question is to consider cases in which courts did void such clauses. The few credit card cases that have done so have looked at a broader range of circumstances to void the arbitration clause, including the circumstances surrounding the formation of the contract.\textsuperscript{178} In doing so,

\textsuperscript{172} Arriaga, 163 F. Supp. 2d at 1193.
\textsuperscript{174} Arriaga, 163 F. Supp. 2d at 1193-95.
\textsuperscript{175} Id. at 1194.
\textsuperscript{176} Id.
\textsuperscript{177} Id. This type of reasoning is ubiquitous in credit card cases interpreting arbitration clauses. See supra note 112.
\textsuperscript{178} An example of a case considering the circumstances surrounding contract formation that has subsequently been positively cited in both federal and state courts said:

The [lower] court's focus on the [alternative dispute resolution (ADR)] clause, standing alone, was misplaced: it is the Bank's exercise of its discretionary right to change the agreement, not the ADR clause in and of itself, which must first be analyzed in terms of the implied covenant. If the Bank's performance under the change of terms provision was not consonant with the duty of good faith and fair dealing, then whether the ADR clause, considered in isolation, satisfies the implied covenant makes no difference.


The Court agrees with the Badie court that the terms discussed in the change-in-terms clause must supply the universe of terms which could be altered or affected pursuant to the clause. To hold otherwise would permit the Bank to add terms to the Customer Agreement without limitation as to the substance or nature of such new terms. . . . Thus, the arbitration clause does not bind plaintiff.

however, these courts were still largely confined to common law defenses such as lack of good faith and unconscionability. The courts did not consider the breadth of context that is typical in cases such as McGill. These claims are also very difficult to win because they require a showing of egregious behavior by defendants. Moreover, the crux of these analyses was whether the lenders provided sufficient disclosure to accomplish contract formation. Courts examined whether lenders had a unilateral right to change the credit card agreement, whether the language was ambiguous, and whether the cardholders had opportunities to request more information.

Perhaps most importantly, even where an arbitration clause does not deprive a cardholder of her day in court, the cardholder’s claims are far less powerful than those available to a mortgagor. Arriaga's claims covered the entire field available to her, yet her bases for relief were limited to claims of inadequate disclosure, pursuant to TILA and other sections of the CCPA, and state law claims for unfair competition, deceptive practices, fraud, and unconscionability. The federal claims focus on the question of whether the defendant properly disclosed its onerous loan terms, without examining the onerous nature of the terms themselves. Meanwhile, state law claims, such as these, typically require very high thresholds of improper behavior to warrant relief. When remedies are granted, litigation is costly and uncertain due to...
the highly fact-specific nature of these defenses.\footnote{187} Moreover, even the broadest state unfair competition laws require an unfair act by the defendant.\footnote{188} These claims, some of which are regularly preempted by broad interpretations of the exportation clause,\footnote{189} provide significantly less protection than property rules, such as the equity of redemption, which requires no bad act by the lender and applies even in the face of defaulting behavior by the borrower.\footnote{190}

Alternatively, the question whether Arriaga could have looked more like McGill could be moot because many credit card contracts have arbitration clauses. Given the rule of deference to arbitration,\footnote{191} it is reasonable to expect that in the vast majority of credit card cases, arbitrators will decide the merits of cardholders' claims of substantive unfairness. Statistics concerning outcomes do not favor cardholders.\footnote{192} Meanwhile, in the mortgage context, statutes govern the important creditors' remedy of foreclosure, not arbitration clauses.\footnote{193}

\footnote{187. See Shanker, supra note 19, at 90-93 (discussing the limitations of the unconscionability doctrine in protecting mortgagors); Jean R. Sternlight & Elizabeth J. Jensen, Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?, 67 LAW \& CONTEMP. PROBS. 75 (2004) (discussing the limitations of unconscionability in preventing businesses from eliminating class action rights of consumers); Russell Korobkin, Bounded Rationality, Standard Form Contracts, and Unconscionability, 70 U. CHI. L. REV. 1203 (2003) (proposing modifications to the unconscionability doctrine to better protect buyers).

\footnote{188. See, e.g., ALA. CODE §§ 8-19-1 to -15 (Supp. 1983); ALASKA STAT. §§ 45.50.471 to .561 (1983); COLO. REV. STAT. §§ 6-1-101 to -114 (1973).

\footnote{189. See supra notes 107-109.

\footnote{190. An example of an important exception is Discover Bank v. Owens where the court denied a bank's collection action because:

Even if plaintiff was technically within its rights in its handling of defendant's account, it was unreasonable and unjust for it to allow defendant's debt to continue to accumulate well after it had become clear that defendant would be unable to pay it.... This court has broad legal and equitable powers, and now brings them to bear for the debtor in this case.

\footnote{191. This is the rule where credit card agreements incorporate the provisions of the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (2005).

While the McGill court responded to the borrower's ignorance about his contractual rights by filling in the picture outside the contract, the Arriaga court found a knowledgeable waiver of rights by the borrower in the absence of fraud or unconscionability. While the McGill court concluded that the writing evidencing the parties' transaction did not represent the actual agreement of the parties, the Arriaga court assumed that it did. And while the McGill court restored a right to the borrower for which he did not explicitly negotiate, the Arriaga court limited the borrower's rights to those evidenced in a writing, which had undisputedly not been negotiated. The result of cases such as these is that ignorant mortgagors have more opportunity to have their fully contextualized day in court, while enlightened credit card borrowers are expected to understand the consequences of agreeing to arbitration and other onerous terms.

B. In the Marketplace: Predatory Credit Card Lending

While it may be unexpected, the stark incongruity in legal treatment of the two types of borrowers described in Part II.A. is well documented. The incongruity in the two credit markets, which this section explores, is less well documented. The phenomenon of predatory lending is integral to this exploration.

Although predatory lending is an established concept in the mortgage market, it has barely been identified in the credit card market. In the

Arbitration, Study Says, 60 Disp. Resol. J. 5 (2005) (finding that “consumers in NAF arbitrations prevailed more often than businesses in cases that went to an arbitration hearing (55% of the cases were resolved in the consumers’ favor”).

193. In non-judicial foreclosure states there is much less process for borrowers, thus, making those foreclosure cases look more like credit card arbitrations.


195. The court only applied the doctrines of fraud and unconscionability to the question of whether the arbitration clause was appropriately negotiated. Arriaga v. Cross Country Bank, 163 F. Supp. 2d 1189, 1193-95 (S.D. Cal. 2001).

196. McGill, 434 N.E.2d at 775.

197. Arriaga, 163 F. Supp. 2d at 1192-93.


199. Arriaga, 163 F. Supp. 2d at 1192-93.


201. The past several years have witnessed an intense scholarly focus on predatory lending in the mortgage context. See Tania Davenport, Note, An American Nightmare: Predatory Lending in the Subprime Home Mortgage Industry, 36 SUFFOLK U. L. REV. 531 (2003); A Tale of Three Markets, supra note 79; Elizabeth Renuart, Toward One Competitive and Fair
mortgage context, a definition of predatory lending has begun to take shape. Most experts in the area agree that it has some or all of the following characteristics: Predatory loans may be made at interest rates and may require fees that are higher than necessary to compensate for risk; they may contain


202. Borrowers who have been victims of credit card issuers, on the other hand, have sought legal action on predatory lending grounds. See Jennifer Harmon, Broker Sues Credit Card Lenders, NATIONAL MORTGAGE NEWS, Oct. 1, 2004, at 44, available at 2004 WLNR 189917 (The former President of the Florida Association of Mortgage Brokers sued nine lenders including Citicorp and Providian after he and his wife felt they had been victimized by being charged usurious rates on their credit cards. Part of the plaintiff’s claim was designed to create a new cause of action in Florida called “Tortious Predatory Lending.”). Consumer advocacy groups as well as certain lenders have been active in trying to prevent borrowers from being victims of credit card predatory lending. See Center For Responsible Lending, http://www.responsiblelending.org (last visited Sept. 13, 2006); Mortgage Bankers Association, http://www.stopmortgagefraud.com (last visited Sept. 13, 2006); National Association of Federal Credit Unions, http://www.nafcu.org (last visited Sept. 13, 2006); National Consumer Law Center, Advance Notice of Proposed Rulemaking Review of the Open-End (Revolving) Credit Rules of Regulation, http://www.nclc.org/initiatives/test_and_comm/content/open_end_final.pdf [hereinafter Revolving Credit]; National Consumer Law Center, http://www.consumerlaw.org (last visited Sept. 13, 2006).

203. A Tale of Three Markets, supra note 79, at 1265-66; Mansfield, supra note 20, at 535-47; Departments of the Treasury and Housing and Urban Development, Curbing Predatory Home Mortgage Lending 21 (June 20, 2000) http://www.huduser.org/publications/pdf/treasrpt.pdf [hereinafter HUD Report]. One study suggests that rate-risk disparities cost United States borrowers $2.9 billion annually and are fueled by the prevalence of incentives to brokers in the form of yield-spread premiums (YSP) to “steer” borrowers into loans that charge higher rates than are justifiable based on the risk posed.
particularly onerous terms, such as large balloon payments and prepayment and late payment penalties.204 They may be "structured to result in seriously disproportionate net harm to borrowers,"205 or they may involve fraud, deception, or "lack of transparency."206 They may "require borrowers to waive meaningful legal redress."207 They may involve "loan flipping," whereby the lender makes a series of loans to the same borrower over a short period of time, charging new fees and sometimes higher interest rates each time.208 Another overarching definition is that predatory loans are typically made to borrowers who cannot access the mainstream credit market either because of low income, racial minority status, or both.209


204. Balloon payments require the borrower to pay off the principal due, or a large portion of it, in one payment at the end of the loan term. Mansfield, supra note 20, at 556. Balloon payments were incorporated into approximately 10% of all subprime loans in 1999; however, this figure varies by lender with at least one lender including balloon payments in 50% of its subprime loans. HUD Report, supra note 203, at 96. Prepayment penalties are designed to "reduce the risk of prepayment and compensate the lender for any cost resulting from prepayment." Id. at 93. There is a shocking disparity between the prevalence of prepayment penalties in the prime market (0.5% to 2% of all loans) versus the subprime market (70-76% of all loans). Id.

205. Engel & McCoy, supra note 201, at 1260.

206. Id. See also HUD Report, supra note 203, at 22 (describing unscrupulous tactics some lenders employ to hide costs from borrowers).


208. Mansfield, supra note 20, 548-50. Another source describes "loan flipping" as follows:

Loan flipping generally refers to repeated refinancing of a mortgage loan within a short period of time with little or no benefit to the borrower. Loan flipping typically occurs when borrower is unable to meet scheduled payments, or repeatedly consolidates other unsecured debts into a new, home-secured loan at the urging of a lender.

HUD Report, supra note 203, at 73.

209. Mansfield, supra note 20, at 559-61. According to one consumer advocacy organization, "Minority homebuyers are more likely to receive a subprime home purchase loan than white homebuyers. African-American homebuyers were 3.6 times more likely to receive a subprime home purchase loan than whites while Latinos were 2.5 times more likely to receive the subprime loan." ACORN Report, supra note 67, at 3 (emphasis omitted). While borrowers in the subprime and predatory markets are traditionally thought to be unable to access prime rate loans due to a negative financial history, there is evidence that a significant portion of subprime mortgage borrowers actually qualify for prime market rates. Freddie Mac reported that 10-35% of its borrowers were found to qualify for prime market rated loans. Freddie Mac, Automated Underwriting Report ch.5 (1996), http://www.freddiemac.com/corporate/reports/moseley/chap5.htm (citation omitted). Another study suggests that 50% of subprime borrowers qualified for prime market rates. Id. (citation omitted). The costs to these borrowers are significant. According to one study, a borrower in the subprime market will pay at least $200,000 more to a lender for a 30-year mortgage than a
This definition of predatory lending is consistent with the ignorant borrower paradigm in that it identifies specific ways in which lenders consistently exploit borrowers' lack of sophistication and information by imposing unfair and onerous terms in the bargaining process. Some predatory loan terms, such as high interest rates and high late payment penalties, had been regulated by state statute or case law prior to the deregulation of mortgage lending. Case law actively policed other types of predatory behavior, such as loans causing net harm to borrowers or involving fraud or deception. It is troubling that federal law has preempted some of these status-based protections, but they at least had the effect of defining certain market behavior as predatory. In other words, these means of exploitation are considered aberrant and inappropriate in the mortgage market.

One of the fascinating things about mainstream credit card lending is that it has so many of the characteristics of predatory mortgage lending. Consider again the Arriaga case. Even ignoring the allegedly fraudulent scheme of pushing borrowers over their credit limits, that credit transaction involved high fees, a lack of transparency in that the lender regularly failed to send monthly account statements, and an arbitration clause which resulted in waiver of rights to a jury trial and a class action lawsuit as a condition of using the credit card. These three characteristics, along with high interest rates, are similarly situated borrower in the prime market. ACORN Report, supra, at 67. One well-cited study estimates that predatory lending costs American borrowers $9.1 billion per year. Eric Stein, supra note 203, at 2.

210. See supra notes 107-109 and accompanying text; see also Saunders & Cohen, supra note 67, at 4 (providing historical background). North Carolina is one of the most active states in legislating to protect consumers from abusive lending practices, despite increased federal deregulation of the market. At least one study indicates this legislative action has decreased the number of predatory loans considerably. Comptroller of the Currency, OCC Working Paper: Economic Issues in Predatory Lending 2 (July 30, 2003), http://www.selegal.org/occ_workpaper0730.pdf [hereinafter OCC Working Paper].

211. Some common law claims still police the most egregious behavior. See, e.g., Richter, S.A. v. Bank of Am. Nat'l Trust & Sav. Ass'n, 939 F.2d 1176 (5th Cir. 1991); Greene v. Gibraltar Mortgage Inv. Corp., 488 F. Supp. 177 (D. D.C. 1980); Peoples Trust & Sav. Bank v. Humphrey, 451 N.E.2d 1104 (Ind. Ct. App. 1983). In Family Financial Services, Inc. v. Spencer, 677 A.2d 479, 481, 485 (Conn. App. Ct. 1996), for example, the court held that the lender behaved unconscionably in making a second mortgage loan requiring a monthly payment of $733.33 to a borrower whose first mortgage monthly payments were $1011.00 and who had a monthly income of only $1126.67. Historical judicial contextualization of the mortgage borrower's story may add to the potency of the common law claims especially.


214. After the introductory period during which a “teaser rate” is in effect, rates can increase by as much as 24%. Jeff Wuorio, Money Matters, The Danger of Spreading Out Credit Card Debt (July 15, 2002), http://www.bankrate.com/brm/news/money-matters/20020715a.asp. Often, one mistake can trigger the jump from the introductory rate to a
virtually universal in credit card lending.\textsuperscript{215} The switch from low introductory rates to often much higher, permanent rates with little or no warning or accompanying information is a classic example of lack of transparency in the credit card market.\textsuperscript{216}

Meanwhile, credit card borrower behavior remains unsophisticated. Extensive research shows that borrowers do not understand the implications of borrowing on a high interest credit card.\textsuperscript{217} Research supported by innumerable


215. The OCC has recognized that "high interest rates and fees, balloon payments, high loan-to-value ratios, excessive prepayment penalties, loan flippings, loan steering and unnecessary credit insurance" occur in the credit card industry as well as the home mortgage industry. OCC Working Paper, \textit{supra} note 210, at 6. Indeed, the National Consumer Law Center has described the entire market for credit-card credit as abusive. \textit{See Revolving Credit, supra} note 202, at 2. The lack of transparency does not ubiquitously take the form of failure to send monthly statements but may involve changes in interest rates and other loan terms without adequate notice to the consumer. One classic manifestation is a universal default rate hike or assessment of penalty fee that is triggered by factors known only by the lender. For example, Consumer Action's 2005 Credit Card Survey found that the following circumstances can trigger a rate hike: decreased credit score (triggered a rate hike 90.48\% of the time), paying another creditor late (85.71\%), exceeding one's credit limit (57.14\%), check bouncing (52.38\%), carrying excessive debt (42.86\%), having too much available credit (33.33\%), obtaining another card (33.33\%), and asking about mortgages or auto loans (23.81\%). Consumer Action, 2005 \textit{Credit Card Survey, CONSUMER ACTION NEWS 3} (2005), \textit{available at} http://www.consumer-action.org. Negative amortization is also widespread in the industry. \textit{See} Mara Der Hovanesian, \textit{Tough Love for Debtors, BUSINESS WEEK ONLINE} (Apr. 25, 2005), http://www.businessweek.com/bwdaily/dnflash/apr2005/nnf20040518_5876_db016.htm.

216. \textit{See} Bar-Gill, \textit{supra} note 5, at 1392-94. Lenders offer first-time consumers or consumers transferring debt from other cards low, sometimes 0\%, introductory interest rates for a set number of months, at which point the introductory rate ends and a substantially higher interest rate kicks in. \textit{Id.} The majority of charge activity occurs after the teaser rates have expired suggesting that most consumers are not vigilantly transferring balances to other cards with teaser rates or are unaware that the introductory offer has ended. \textit{Id.} Typically, teaser rates only last for about 6 months. \textit{Id.} Frequently, only the consumer who has a high credit rating will qualify for the advertised teaser rate. Bankrate.com, \textit{Step-By-Step Guide to Balance Transfers} (Mar. 1, 2005), http://www.bankrate.com/brm/green/cc/basics4-3a.asp. Credit companies might promote a teaser rate of 3.9\% that goes to 17\%, but the consumer with less then perfect credit could be charged up to 7.9\% initially and then 21\% after the teaser expires. \textit{Id.}

217. The Consumer Federation of America and Providian conducted a joint survey in 2004
anecdotes also shows that borrowers are surprised by the high fees imposed for exceeding credit limits, late payments and similar breaches of the credit card contract. Generally, borrowers do not shop for better deals on terms such as these. Even if they are sophisticated enough to understand the language in their contracts describing these terms, the terms are so standard in the industry that borrowers have neither the option to get credit elsewhere nor the power to bargain them away.

The consequence is that the information asymmetry that is the hallmark of the predatory mortgage market permeates the mainstream credit card market. Credit card lenders understand the credit market intimately, and they deluge borrowers with advertisements for credit cards and related products that appear highly desirable. Meanwhile, borrowers rarely read the fine print in the advertisements and contracts they receive, relying on the statements in bright,
bold letters to make decisions about which card to obtain.\textsuperscript{222} Compounding these asymmetries are the well-documented biases that seduce borrowers into believing that they will not borrow as much as they ultimately do.\textsuperscript{223} This problem will only worsen as lenders market to more low-income borrowers who may believe that they have no other options for obtaining credit.\textsuperscript{224} Yet the behavior of credit card lenders is not characterized as predatory, aberrant, or inappropriate; instead, it is very well protected by credit card law. As \textit{Arriaga} exemplifies, the contract rules supporting the enlightened borrower paradigm affirm loan terms generated by information asymmetry as an acceptable consequence of private bargaining.\textsuperscript{225} Credit card case law assumes equal bargaining power and sophistication. As a consequence, credit card law has validated terms that mortgage lending historically found to be unacceptable.\textsuperscript{226} While mortgage law’s ignorant borrower paradigm delegitimizes certain lending activities as unacceptably exploitative, credit card law's enlightened borrower paradigm legitimizes these same lending activities as benefits of the bargain.

The new enlightened borrower paradigm has a broader legacy than the limitation on borrowers’ rights and remedies described in the previous section. Its legacy is also to make a much broader range of lender behavior, including the exploitation of information asymmetries, positively normative. Indeed, it has made credit itself positively normative.\textsuperscript{227}

\textbf{C. In Congress: The Response As Epitomized by Federal Legislation}

The law has not failed completely to recognize that abuses exist in the credit card market; however, the legislative response to abusive practices in the mortgage and credit card markets is entirely consistent with the dominant paradigms in each. Although similarly predatory practices exist in both

\begin{itemize}
  \item \textsuperscript{222} Revolving Credit, supra note 202, at 26.
  \item \textsuperscript{223} See, e.g., Lawrence M. Ausubel, The Failure of Competition in the Credit Card Market, 81 AM. ECON. REV. 50 (1991); Bar-Gill, supra note 5, at 1395-1401; Forrester, supra note 13, at 383-87 (discussing these biases in the context of home equity lending).
  \item \textsuperscript{224} Credit card lenders market aggressively to many different demographics and are now increasingly targeting low-income borrowers. SULLIVAN ET AL., supra note 5, at 135-36; National Consumer Law Center, Predatory Small Loans: A Form of Loansharking: The Problem, Legislative Strategies, A Model Act, http://www.consumerlaw.org/initiatives/payday_loans/pay_menu.shtml ("From 1993 to 1996, the proportion of households with incomes under $20,000 who received credit card offers rose from 40\% to 50\%.").
  \item \textsuperscript{225} Arriaga v. Cross Country Bank, 163 F. Supp. 2d 1189, 1194-95 (S.D. Cal. 2001) (determining that Arriaga was an enlightened borrower led the court to assume that she knew about and assented to the arbitration clause she later sought to have declared unconscionable).
  \item \textsuperscript{226} Compare Id. (validating a credit card arbitration clause), and McGill v. Biggs, 434 N.E.2d 772 (Ill. App. Ct. 1982) (finding a mortgage instead of a warranty deed using extrinsic evidence).
  \item \textsuperscript{227} Part III provides a more detailed discussion of this evolution in norms.
\end{itemize}
markets, Congress has enacted two markedly different statutes to counteract them; the statute regulating mortgages defines certain lending terms as abusive\textsuperscript{228}, while the statute regulating credit cards defines the failure to adequately disclose such terms as abusive.\textsuperscript{229}

1. The Home Ownership and Equity Protection Act

The Home Ownership and Equity Protection Act of 1994 (HOEPA)\textsuperscript{230} has been much maligned by consumer advocates.\textsuperscript{231} It manages to eliminate only the most egregious abuses in the predatory lending market\textsuperscript{232} and is very easy for lenders to evade.\textsuperscript{233} At the same time, consumer advocates and others in the field regularly refer to HOEPA as a "de facto usury law," making it the only federal law capping interest rates on consumer loans in any respect.\textsuperscript{234} And though it is less protective than many state laws, HOEPA's protections are significantly more interventionist than those of the disclosure regime. For example, HOEPA limits prepayment penalties,\textsuperscript{235} bans negative amortization,\textsuperscript{236} and prohibits balloon payments on short-term loans.\textsuperscript{237} The statute effectively

\textsuperscript{228}. See 15 U.S.C. § 1639(c), (e), (f).
\textsuperscript{232}. Azmy, supra note 201, at 355-56.
\textsuperscript{233}. Although recent changes have eliminated some loopholes, lenders can simply offer mortgage rates slightly below the statute's annual percentage rate (APR) floor or utilize financing options that HOEPA does not cover, such as purchase-money mortgages and open-ended credit lines. See Azmy, supra note 201, at 352-56; A Tale of Three Markets, supra note 79, at 1308.
\textsuperscript{234}. See, e.g., Christopher L. Peterson, Federalism and Predatory Lending: Unmasking the Deregulatory Agenda, 78 TEMP. L. REV. 1, 63 (2005).
\textsuperscript{235}. 15 U.S.C. § 1639(c). The term prepayment penalty is liberally applied to include any method of accruing unearned interest that places the consumer in a less favorable position than the actuarial method. Id. Prepayment penalties are allowed, however, if the consumer is refinancing through a different creditor than that of the original mortgage, or if the consumer's mortgage payment is less than a specified percentage of her income as verified through fiscal records. 15 U.S.C. § 1639(c)(2).
\textsuperscript{236}. 15 U.S.C. § 1639(f). The consumer's mortgage payments must compensate fully for the interest due, thus decreasing the balance with each payment. Id.
\textsuperscript{237}. 15 U.S.C. § 1639(e). For mortgages lasting less than five years, the consumer must be
caps interest rates, mainly by expanding liability to assignees of above-market interest loans. The statute even provides a very narrow version of the suitability requirement proposed by Professors Engel and McCoy as a way to curb predatory lending. In these respects, HOEPA restores some of the state law substantive protections that were eliminated by AMTPA and DIDMCA.

It is not surprising that substantive protection arises in the realm of mortgage lending. Consistent with the ignorant borrower paradigm, HOEPA addresses information asymmetries in the predatory mortgage market by overriding particularly egregious terms of the lending contract. Rather than requiring more complete disclosure to the borrower about the consequences of accepting such terms, the statute simply prohibits certain types of penalties and payment terms.

2. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

In credit card lending, the recent legislative attempts to curb abuse are best represented by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), which has received much attention for its sweeping restrictions on consumer bankruptcy. A less well-publicized part of the Act, however, seeks to protect credit card borrowers by requiring more stringent disclosure. The statute requires that lenders on open-credit accounts (which include virtually all credit card accounts) that require a minimum monthly payment of less than a certain percentage of the overall debt owed must include prominent text on the front of the billing statement that reads as follows:

Minimum Payment Warning: Making only the minimum payment will increase the interest you pay and the time it takes to repay your balance. For example, making only the typical 2% minimum monthly payment on a

able to amortize the balance through the scheduled payment terms and lenders cannot require additional payments that increase the loan balance. Id.


239. HOEPA’s suitability requirement prohibits creditors from engaging in a “pattern or practice” of awarding mortgages to consumers without considering their repayment aptitude in light of their financial status. 15 U.S.C. § 1639(h). Professors Engel and McCoy conclude that HOEPA’s provision is too narrow to be effective and call for congressionally mandated self-regulation, an industry power to regulate, and a federal cause of action for breaching the standard’s imposed duties. A Tale of Three Markets, supra note 79, at 1337-44.


241. See Id.


243. Id.
balance of $1,000 at an interest rate of 17% would take 88 months to repay the balance in full. For an estimate of the time it would take to repay your balance, making only minimum payments, call this toll-free number: __________ (the blank space to be filled in by the creditor).244

The statute also requires prominent warnings regarding the timing and amounts of late payment penalties that may be charged,245 as well as the terms of any introductory or teaser interest rates that may be used.246

The federal statutory response to the credit card market continues to focus on improving disclosure.247 Rather than capping late payment penalties to the amount required to cover the lender's costs and risks, or banning them outright, the statute requires more prominent warnings.248 In doing so, the most recent law on credit cards demonstrates a continuing affinity for the enlightened borrower paradigm. Credit card law does not define exorbitant late payment penalties and negative amortization as inherently abusive, but rather it defines the practice of withholding information about such terms as abusive. Congress has taken this approach despite evidence that the information asymmetries in the mainstream credit card market are as extreme, if not more so, than in the predatory mortgage market.

III. WHAT DOES THE FUTURE HOLD?

As Americans continue to borrow more, consume more, and save less, the likelihood of continuing abuses in the consumer credit market appears high. One of the critical questions for lawmakers in the next decade will be whether the disclosure regime of the last four decades is the appropriate choice for balancing access to credit against exploitation of the consumer borrower. The response to this question should be a conscious decision rather than a default rule based on either tradition or convenience. Part III.A. predicts the future of consumer credit regulation if lawmakers stay their current course. Part III.B. raises some issues that lawmakers should consider in regulating the credit card market.

A. The Current Course of Regulation

It is possible that the ignorant and enlightened borrower paradigms will exist in equipoise in the two major markets for consumer credit, but it does not seem likely. Recent developments in the residential mortgage market signify an increasing shift towards the disclosure regime of the credit card world. The

247. Id.
deregulatory trend continues in the banking industry, preemption of substantive state law protections for the borrower. The Ney-Kanjorski bill, if enacted, could result in much broader preemption of substantive state law protections for the borrower. Meanwhile, Congress has focused much of its consumer protective energy on tweaking RESPA and HOEPA to impose better disclosure requirements on mortgage lenders. Although HOEPA does impose substantive protections for the mortgage borrower, it is not nearly as effective at curbing abuses as its state law predecessors and successors. Overall, mortgage law is becoming more contractarian and less status-based. If this trend continues, the ignorant borrower paradigm could eventually be a legal imprint of the past.

Thus far, consumer advocates have opposed these developments, arguing instead for more substantive consumer protections, such as usury caps, and elimination of the exportation clause and other instruments of preemption, which limit the applicability of more protective state laws. These efforts are well-intentioned, admirable, and, in some respects, effective. Such efforts may lead to more HOEPA-like protections. Abuses in the credit card industry may garner enough attention to generate an open-end credit statute that caps certain types of penalties, prohibits negative amortization, and imposes usury caps. Perhaps the BAPCPA is a first step in that direction. Lawmakers may also scrutinize more thoroughly abuses that are typically outside the realm of private ordering, such as advertising, which occurs before a contract is formed, and debt collection practices, which are not easy to anticipate at the time of contract formation.

These efforts, however, often do not attack disclosure for being largely ineffective, thus implicitly affirming lawmakers' predilection to regulate disclosure only. Academic literature has detailed the failures of the credit

249. See, e.g., Wachovia Bank, N.A. v. Burke, 414 F.3d 305, 309 (2d Cir. 2005) (holding that the National Bank Act preempts Connecticut laws subjecting national bank subsidiaries to licensing and other requirements).

250. See supra note 77.


254. See, e.g., Zieger, supra note 220(describing a proposed New York statute that would prohibit credit card issuers from raising interest rates or fees on the basis of unrelated activity on a cardholder's credit report).

255. But see Revolving Credit, supra note 202, at 25-27 (arguing that abuses in the credit
card disclosure requirements that currently exist.\textsuperscript{256} Although some of these authors have proposed improved forms of disclosure,\textsuperscript{257} it is hard to imagine that these new reforms will work. Disclosure fails for too broad a range of reasons to be rehabilitated. For example, although the BAPCPA requires new warnings stating the number of months required to repay a loan,\textsuperscript{258} it does not require a potentially more attention-grabbing statement of the total amount owed at the end of that time period.\textsuperscript{259} Nor is there any evidence that consumers will be alarmed by merely a statement of a time period required to repay a loan. Even if a statement of the total amount owed were statutorily required, it is hard to believe it could make much impact when consumers so rarely read their credit card contracts. Borrower education proposals face some of the same difficulties.\textsuperscript{260} Consumers are already too broadly acculturated to ignoring fine print, to the ease of applying for credit cards, and to the overall lack of gravity in credit card borrowing.

Consequently, the incremental changes under way, many of which are still anchored in the disclosure regime, will be ineffective in the face of increasingly aggressive practices of lenders in both markets. This Article does not propose that mortgage law, either in its current or historical form, is the answer to the problems in the credit card or predatory mortgage lending markets. As the continuing abuses in the subprime mortgage market demonstrate, the combined effect of rights of redemption, foreclosure protections, and judicial reinterpretations of the loan agreement are insufficient to stop predatory lending. It is questionable whether more stringent usury caps would even suffice.

Nor does this Article assert that the distinction between status and contract is either wholly accurate or ultimately even meaningful. After all, by seeking an expansive freedom to contract, credit card lenders seek legal enforcement of their more privileged status vis-à-vis their borrowers. This Article proposes, however, that mortgage law embodies a regulatory approach, grounded in protecting the particular status of an ignorant borrower, which is not evident in credit card law. While the individual substantive protections that have arisen from this status-based regulatory approach in mortgage law could be improved,
the underlying approach has led to the greater level of substantive protections in mortgage law.

Could and should such a status-based approach also improve protections for credit card borrowers? Such protections might be justified if, as appears to be the case, the disclosure regime sustains an abusive market. Such protections would seem especially appropriate if credit card loans were accomplishing some of the same socially beneficial purposes as mortgage loans. Thus, integral to a decision concerning whether the disclosure regime is the right choice for the future is a deeper understanding of why the paradigm shift in consumer lending occurred and whether it is based on real differences between mortgage and credit card borrowing. The concluding section of this Article explores these questions.

B. Distinctions Without a Difference

Although the switch in borrower paradigms may seem both natural and rational, it is increasingly grounded in a set of distinctions without a difference. This section examines two explanations for the switch in paradigms and the assumptions underlying these explanations. In concluding that these assumptions are no longer true, this Article suggests that credit cards facilitate a new role for credit that serves purposes previously only served by secured credit. This new role for credit requires a new inquiry into the legitimacy of the enlightened borrower paradigm.

Two explanations appear to justify the enlightened borrower paradigm. Both have been the subject of too little scrutiny. The first is the lack of security in credit card lending. The security at issue in mortgage lending is typically the borrower's most unique and cherished asset, and it is likely that many modern-day judges and legislators can empathize with the catastrophic losses associated with this form of lending. The lender receives an extraordinary benefit from the threat to the borrower of loss of her home. Historically, the law has counterbalanced this benefit by preventing lenders from overreaching in their right to the security.\(^2\)\(^\text{61}\) For example, early in mortgage law's history, courts enunciated the rule that the mortgagee's title did not signify ownership, but rather merely security.\(^2\)\(^\text{62}\) Compounding this empathetic response is the historical maxim to promote utilization and alienation of land.\(^2\)\(^\text{63}\) In the context of mortgage lending, this principle bodes in favor of keeping the land in the hands of the owner who is making active use of it, rather than the lender who merely has a security interest in the land. The former, by virtue of her past

\(^{261}\) See Osborne, supra note 19, at 13, 25.

\(^{262}\) Id.

\(^{263}\) See, e.g., Joseph W. Singer, Property Law: Rules, Policies and Practices 557-58 (3d ed. 2002) (discussing the connection between this maxim and the modern law of estates); Oliver S. Rundell, The Suspension of the Absolute Power of Alienation, 19 Mich. L. Rev. 235 (1921) (discussing the connection between this maxim and the promotion of land's alienability). This maxim also helps justify specific performance as a remedy in property cases.
behavior, has proven her interest in using the land, while the latter is untested in that regard.\textsuperscript{264}

Credit card lenders who do not have the benefit of such potent security, might justifiably expect fewer legal constraints on their ability to protect themselves from the risks of unsecured lending. They might argue that the more onerous terms of their lending contracts reduce their risk in some of the same ways that collateral limits risk for a secured lender.\textsuperscript{265} Onerous penalty clauses might deter borrowers from defaulting in the same way as does the threat of losing their homes.\textsuperscript{266} Without such clauses, unsecured creditors may be unwilling to risk lending without any security.

The second explanation for the switch to the enlightened borrower paradigm is the existence of different roles for mortgages and credit cards in wealth formation. At the most basic level, the mortgage transaction connotes ownership because the quintessential use of a residential mortgage loan is to purchase the property used as collateral.\textsuperscript{267} Every time a mortgagor makes a mortgage payment, she is building her equity.\textsuperscript{268} In this respect, mortgage loans contribute directly to capital formation.

Moreover, by protecting the borrower's collateral, mortgage law has traditionally encouraged consumer participation in the market for land, both as a buyer via the mortgage loan and as a seller by sale of the home and use of the equity, ideally to purchase a more expensive home. Protection of the borrower's collateral perpetuates a market in residential real estate, while onerous lender's remedies, such as strict foreclosure, might chill such a market.\textsuperscript{269} Such a chilling effect would not be limited to the borrower at issue. Consider, for example, the negative externalities resulting from loss of a home

\begin{enumerate}
\item[264.] The historical image of the home as one's castle, as described by Professor Singer in his recent analysis of takings law, probably contributes to judicial sensitivity to the plight of mortgage borrowers. See Joseph William Singer, The Ownership Society and Takings of Property: Castles, Investments, and Just Obligations, 30 HARV. ENVTL. L. REV. 309, 314-15 (2006). I am grateful to Professor Singer for pointing out that another context in which consumers are treated as enlightened is landlord/tenant law, where “enlightened” tenants historically have received less protection than “ignorant” homeowners.


\item[266.] Moreover, the argument would continue, the backstop to such deterrence measures should be whether they are unconscionable, not whether they risk loss of a cherished asset because there is no obvious cherished asset at risk.

\item[267.] Home equity loans complexify this picture. Their relatively more recent development as a mainstay of consumer borrowing blurs the line between mortgage and credit card credit.

\item[268.] An exception here is financing with an interest-only component, for the period during which only interest is paid.

\item[269.] On the harshness of strict foreclosure, see Osborne, supra note 19, at 651-53; Wechsler, supra note 41, at 858-60.
\end{enumerate}
to foreclosure. Foreclosure may result in a below-market sales price or, worse yet, in an empty, boarded-up home accompanied by the neighborhood deterioration that the broken windows theory would predict. Mortgagor protections promote alienability, a fundamental goal in American property law. In these respects, the ownership society created by mortgage-based credit produces far-reaching social benefits.

Credit cards do not so obviously contribute to wealth formation. Credit card borrowers do not use their loans to purchase land, nor do they build equity when they repay their loans. As described by Professors Sullivan, Warren, and Westbrook, credit card funds typically are used to purchase consumable goods and services, such as restaurant meals, clothing, and vacations. Thus, while the quintessential role of mortgage-based credit is to facilitate ownership of an asset that generally appreciates in value, the quintessential role of credit card credit is to facilitate ownership of assets that depreciate quickly. Normally, such assets are not unique, and, thus, do not warrant specific performance remedies in the event of their confiscation.

Credit card credit produces market participation by borrowers as buyers but far less robust participation as sellers. The market for used clothes and sneakers typically has resale prices far below the original purchase prices, while there simply is no market for half-eaten pizza or unused fitness club memberships. In other words, while credit card credit is integral to keeping consumption high, it has a less obvious socially beneficial role in wealth formation.

If accurate, these two explanations may justify a less protective disclosure regime in credit card law, but they fail to explain why the choice for consumers between mortgage and credit card credit is so subtle. This is a troubling disconnect, and it demands careful research into the distinctions between secured and unsecured consumer credit. What is needed is an examination of how credit cards change the traditional assumptions that underlie these deep-rooted explanations for the switch in paradigms. In particular, two assumptions appear far more questionable since the ascendance of the credit card.


271. In addition to the rise of home equity loans, an important cross-current in the real estate world is the refinancing craze of the last several years. This phenomenon challenges the traditional assumptions about the benefits of mortgage lending by, for example, artificially inflating home values, encouraging the use of money from refinancing to purchase consumable goods rather than to save or invest and churning debt rather than creating new opportunities for home ownership. For statistics and comments about the refinancing phenomenon, see, e.g., William R. Emmons, Consumer-Finance Myths and Other Obstacles to Financial Literacy, 24 ST. LOUIS U. PUB. L. REV. 335 (2005); Freddie Mac, Cash-Out Refinance Activity Rises in Second Quarter (2005), http://www.freddiemac.com/news/archives/rates/2005/2qupb05.html.

272. SULLIVAN ET AL., supra note 5, at 111.
The first assumption is that physical assets are necessary for credit to accomplish wealth formation. Said another way, conventional wisdom is that equity cannot be accumulated unless the loan is used to buy an asset that can later be resold. Without the ability to build equity in an asset, credit cannot serve the purpose of enhancing the wealth of the borrower. This assumption is built on the equally traditional beliefs that wealth consists of assets not debts and that it is socially beneficial to promote the attainment of such assets. Credit cards challenge this assumption. Using credit to build equity in a house is one important means to accomplish wealth formation, but it is no longer the only means. In our modern times, credit itself is an important form of wealth. For example, by enabling the purchase of designer clothing and fine dining, credit cards enhance social status, as do other forms of wealth. Credit card credit also provides a means to acquire greater wealth and to invest in capital assets as do other forms of wealth. Moreover, the more an individual uses credit cards, the more credit she typically acquires by means of increased credit lines. In this respect, too, credit card credit functions like other forms of wealth.

Notably, this use of credit cards is a new role for credit in American society, at least on such a large scale. Prior to the ascendance of the credit card, consumers rarely purchased consumable goods or services with credit, with the exception of the automobile loan. To some, this is a positive development. Credit cards give individuals more options to borrow. For those who do not own a home, credit cards open up a new world of market participation. While these new status enhancers appear to be gaining

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273. I focus on physical collateral here because the home is the paradigmatic collateral.

274. Here, the term "status" signifies something different from a borrower's position in a class of borrowers, such as mortgagors, but rather connotes a rise in economic welfare, social welfare, or both.

275. See, e.g., Creola Johnson, Maxed Out College Students: A Call to Limit Credit Card Solicitations on College Campuses, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 191, 221 n.129 (2005) (describing a study that found on one campus "68.8% of students surveyed used their credit cards to pay for tuition, books, and supplies"). Many small business owners also use credit cards to start up or keep their businesses afloat. See SULLIVAN ET AL., supra note 5, at 115-19.


277. Certainly there have always been informal means of financing the purchase of consumer goods, see, e.g., Austin, supra note 201, but both the formality and the breadth of such financing were introduced by the credit card.

278. This refers to the merchant credit cards of the early 20th Century. See SULLIVAN ET AL., supra note 5, at 109.

279. Note also that there is a much more robust market in used cars than in used clothes.

importance in modern society, the more basic point here is that in this new role, credit cards accomplish wealth formation.  

The second questionable assumption is that something tangible must serve as collateral for the borrower to perceive enough risk that she will have an incentive to repay her loan. This is one of the most basic assumptions of secured lending. While unsecured lenders compensate for this lack of security with higher interest rates and more onerous penalty clauses, conventional wisdom is that these deterrents can never be as effective as the risk of loss of one's home. The latter is catastrophic to borrowers across the board, while the former deters those who are relatively confident of repaying their loans, those who have assets that may be liquidated through judgment liens, or those who expect to borrow repeatedly from the same lender. Onerous terms do little to deter those one-time borrowers whose prospects are very risky and who have little to lose from default—or so the assumption goes.

Credit cards challenge this assumption as well. Credit card borrowers encounter enormous risk in the borrowing process that is not limited to onerous loan terms and higher interest rates. Credit card borrowers risk their homes, physical assets, and much more. Because credit bureaus track their payment histories, borrowers risk their reputations as creditworthy individuals. If their credit ratings are negative, they risk loss of opportunities to obtain designer clothes, health club memberships, and rental cars. They also risk loss of credit. In this respect, they risk loss of significant wealth. It does not seem an overstatement to say that a person cannot be a member of the middle class in the United States without having an acceptable credit rating.

Credit cards have normalized the use of a new, non-physical form of collateral in consumer lending. Whether this new collateral is called reputation, honor, dignity, or shame, it is a powerful deterrent to default in the market for consumer credit, and it operates much like the threat of loss of one's home. Most of us, like Andrea Arriaga, cannot risk negative credit reports. In her case, this threat precluded her from opting out of the onerous contract imposed by the credit card lender. Thus, credit card lenders do, in fact, receive an

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281. This function is not necessarily through resale, as with houses.


283. This reasoning leads banks to ration credit to more marginal borrowers. For discussions of this phenomenon, see Keith N. Hylton, Banks and Inner Cities: Market and Regulatory Obstacles to Development Lending, 17 Yale J. on Reg. 197, 207-17 (2000); Michael Klausner, Market Failure and Community Investment: A Market-Oriented Alternative to the Community Reinvestment Act, 143 U. Pa. L. Rev. 1561, 1565-66 (1995); see e.g., Joseph E. Stiglitz & Andrew Weiss, Credit Rationing in Markets with Imperfect Information, 71 Am. Econ. Rev. 393 (1981).

extraordinary benefit in their transactions with consumers, one that mimics some of the important advantages of collateral.

In both these respects, the use of credit as wealth and the collateralization of dignity, the line between secured and unsecured borrowing is becoming blurred and the justifications for two different paradigms much less obvious for the consumer borrower.\textsuperscript{285} While the law encourages mortgage borrowers’ wealth-improving use of credit by protecting their ownership of the collateral, it fails to recognize the wealth formation accomplished by credit card borrowing and leaves these borrowers to suffer extraordinary losses with little legal protection. Moreover, this new role for credit suggests that both the current enlightened borrower legal regime and many of the reforms proposed by consumer advocates may be off the mark. Rather than drawing lines on the traditional battlefield between access and exploitation, the more productive strategy for lawmakers and advocates may be to consider how to enhance the wealth-forming potential of credit card borrowing.

Mortgage law’s focus on the ignorant borrower provides a valuable place to begin redefining credit card policy. By reintroducing the borrower’s status as a basis for protection, this Article intends to refocus the debate about credit cards on questions about their ability to fulfill the role for credit that they have helped to create. Among the important questions that ought to be explored is the extent to which the freedom of contract sought by credit card lenders imposes both unacceptable risks on credit card borrowers and negative externalities on those who have to suffer the social and economic consequences of catastrophic problems that can result from unregulated credit card use. What exactly are credit card borrowers risking? What is the nature of the losses that defaulting credit card borrowers suffer? How do these losses affect credit card borrowers’ ability to enhance their wealth? And how can the law facilitate their recovery from loss and their continued participation in wealth formation? Questions such as these ought to elucidate the winners and the losers, those in greater need of protection, and those who require more regulation in the current market for credit card credit.

IV. CONCLUSION

In the market for consumer credit, might status, and not contract, be the way to progress? The emergence of the enlightened borrower paradigm in the law of credit card lending requires us to consider this question. Given the unfavorable legal and market consequences of switching to this paradigm, the answer may be yes.

\textsuperscript{285.} Certainly, the law does not blur this line, but rather consumer behavior treats the two kinds of debt more interchangeably. Both kinds of debt do contribute to wealth formation.