Testimony of

Robert M. Lawless

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WRITTEN TESTIMONY OF PROFESSOR ROBERT M. LAWLESS
University of Illinois College of Law
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My name is Robert Lawless, and I thank you for extending me the privilege to speak with you today. In my work as a Professor of Law and the Galowich-Huizenga Faculty Scholar at the University of Illinois College of Law, I study bankruptcy and financial services law. My research includes surveys and interviews with everyday Americans that help to tell us how these laws and the courts' applications of these laws puts economic pressure on families. Also, I have had opportunity to write about the role of the Supreme Court in financial services and offer academic commentary on the changing economic nature of the American family on our jointly authored blog, Credit Slips.

This work shows how very technical and dry regulatory issues--issues that only a lawyer could love--can end up as Supreme Court cases that dig into the pocketbooks of consumers. These cases are litigated outside the blare of the media spotlight, followed closely only by experts and obscure to the millions of consumers who will bear the brunt of the decisions. The committee is to be commended for convening this hearing and casting some light on the importance of these underappreciated cases.

This is not a partisan issue, not a matter of the justices or some subset of the justices sitting in a room and deciding to be "pro-business" or "anti-consumer." Instead, it is a simple fact of our political system that cases are going to end up in the Supreme Court where business interests will have systematic advantages. The good news is that there are measures Congress could take to restore some of the balance. This is not the place for a dry recitation of dozens of case holdings, but it is appropriate to begin with an overview of a few illustrative examples.

I.Some Examples of Supreme Court Cases Where Business Won Big

a.Credit Card Debt, Interest Rates, and Fees

In his comments to the Federal Reserve's proposed regulations to prohibit unfair credit card practices, Mr. Michael Rosado of Elkton, Maryland, writes about how a credit card company's mistake resulted in penalty rates that rose into the "high 20's." As a citizen of Maryland, Mr. Rosado is protected by a usury law that prohibits a creditor from charging more than 24% interest. How is it possible, then, for Mr. Rosado to be charged interest over 24%? Because of the Supreme Court's decision in Marquette National Bank v. First of Omaha Serv. Corp., the Maryland usury statute is virtually worthless to Mr. Rosado and every other Marylander. National consumer lenders operate in an environment that is free of usury restrictions because of the Marquette decision.

Marquette's legacy is not just about the cost of consumer debt but also the amount of it. There is now more than $53,000 in mortgage and consumer debt for every man, woman, and child in the United States. That figure represents an average across everyone--those with credit card debt and those without, adults and children, the young and the old; homeowners and renters. Our personal debt outstrips our annual personal income, which was not true as recently as 2003. If, as a nation, we devoted all of our personal income this year to debt repayment--forgoing things like shelter, food, health care, and all other necessities--we still would not retire our outstanding personal debt.

In Marquette, the issue revolved around the interpretation of five words in section 85 of the National Bank Act. Other than experts in the banking industry, few people would have any idea of what section 85 provides or, for that matter, what the National Bank Act provides. Passed in 1864, the National Bank Act created a national banking system and was intended to help create a stable national currency amidst the financial chaos of the Civil War.
Section 85 of that law allows a national bank to charge an interest rate allowed by the state "where the bank is

located." By enacting section 85, Congress wanted to protect nationally chartered banks from predatory state legislation designed to drive the nationally chartered banks out of business to the benefit of state-chartered. In 1864, bank lending was primarily a local business. Banks lent on the strength of personal relationships with members of the local community. The idea that a bank in one state would seek out lending business with citizens in another state was simply not something an 1864 Congress would have considered.

By 1978, information technology had dramatically changed the potential meaning of section 85. The Marquette case had its genesis in the decision of a Nebraska bank to expand its operations and lend to Minnesota citizens at an interest rate greater than allowed under Minnesota law but less than the amount allowed under Nebraska law. First of Omaha Bank argued that section 85 allowed it to charge the interest rate allowed by Nebraska law, the interest rate allowed by the state where First of Omaha was physically located. Although Congress had intended section 85 as a shield for national banks, First National Bank of Omaha now wanted to use section 85 as a sword to export Nebraska's interest rate into Minnesota. Ignoring the purpose of the National Bank Act and Congress' original intentions, the Supreme Court agreed with First National Bank.

The effect of the Marquette decision cannot be understated. Because a national bank now could charge whatever interest rate its own state allowed, some states simply repealed their interest rate caps. The national banks flocked to these states, set up operating subsidiaries, and began issuing credit cards at interest rates that would have been illegal under the state law where consumers were using these credit cards. Whichever states were willing to race to the bottom and offer the fewest consumer protections would win all of the consumer credit business. When consumers wonder how it can possibly be legal to get charged an interest rate that would have been considered usurious a generation ago, they can look to the Marquette decision.

With banks able to charge whatever interest rate they could get customers to pay, household debt exploded, and this increase in household debt is one of the greatest changes of our generation. We have come from a society where consumer debt was unusual to a society where consumer debt is ubiquitous. Where our parents would have been shocked to hear a neighbor owed a great deal of money, we now have conversations where permanent indebtedness is discussed a way of life. All of these effects can be traced to a decision of the United States Supreme Court.

Today's consumers know that it is not just the interest rates that credit card companies charge but also the fees. For example, late fees on credit cards average close to $35 and have more than doubled since 1996. What happened in 1996? In Smiley v. Citibank (South Dakota), the Supreme Court extended the logic of Marquette to credit card fees.

In Smiley, a citizen of California sought the protection of California state law against late fees Citibank charged on top of the exorbitant penalty default interest rates that Marquette already had allowed. Citibank again turned to the same words in the National Bank Act as had been at issue in Marquette. The difficulty for Citibank was that the National Bank Act said the bank could charge "interest" as allowed by the law where the bank was located and a late "fee" did not seem to be the same as "interest." Nevertheless, Citibank was able to cite an interpretive regulation of the Office of the Comptroller of the Currency (OCC) that said the term "interest" included any compensation paid to a lender including late fees. The OCC had equated "interest" and "fees," which was quite helpful to Citibank's legal case. Although the Supreme Court viewed the question as close, it placed particular emphasis on the OCC's regulation and ruled for Citibank.

Smiley led to the same dynamic as happened after Marquette: when it came to fees banks simply exported the law most favorable to the banks, meaning an Illinois or Pennsylvania consumer would have to pay whatever fee the law of another state allowed. When consumers pay a $39 late fee, a 3% currency conversion fee, or a 3% balance-transfer fee, they can look to the Smiley decision for the reason why.

b. No Help for Homeowners in Bankruptcy

It is hardly novel to point out that America is in the middle of a debt crisis. According to newly released statistics from the Mortgage Bankers Association, nearly one in ten Americans are experiencing difficulty with their home loans, either facing foreclosure or behind in their payments. Many of these homeowners owe more than their home is worth.

For these homeowners, bankruptcy court does not provide the relief it could. As committee members are probably aware, Senator Durbin has introduced S. 2136 to address this shortcoming and give bankruptcy judges the tools they need to help keep financially troubled Americans in their homes. Bankruptcy is no shortcut and only gives a second chance to the honest but unfortunate debtor. It does not wipe out obligations for which a lender holds collateral. Failure to pay a car loan or home mortgage, even after bankruptcy, will result in foreclosure and repossession. To receive a discharge, debtors have to turn over all of their assets to the bankruptcy trustee or devote all of their disposable income for three to five years to repayment of creditors. Moreover, bankruptcy judges have discretion to provide more limited relief or to dismiss cases where particular circumstances indicate abusive behavior by a debtor. What bankruptcy judges lack are effective tools to deal with the home mortgage mess in which we find ourselves.

Senator Durbin's bill addresses this imbalance and simply would put a lender in the same position it would be outside of bankruptcy if it had gone through a foreclosure and extended another loan on the property. Homeowners would have to pay off the value of the home over time at the current market rate of interest. If the payments were not completed, the bank would still have the right to take the home. Senator Durbin and his cosponsors--including Senators Biden, Feinstein, Schumer, and Whitehouse of this committee--are to be commended for sponsoring this important piece of legislation.

Senator Durbin's legislation would have been unnecessary had the Supreme Court not taken this power from the bankruptcy judges in a case called Nobelman v. American Savings Bank. In that case, a married couple owed more than $71,000 on a condominium that no one disputed was worth more than $23,500. Using chapter 13, they asked a bankruptcy court to put the bank in the position it would be in a foreclosure--requiring them to pay the value of $23,500. If the Nobelmans could not make this payment, the bank would still have the power to take the condominium. The dollar amounts tell us this was not an extravagant spender seeking protection on a multimillion dollar mansion. This was a modest home for which the debtors turned to the bankruptcy courts in an attempt to keep it.
By the time they got to the Supreme Court, these everyday realities had turned into a legal debate that would keep only a bankruptcy lawyer's interest. At issue was the interaction of complex statutory provisions scattered throughout the Bankruptcy Code, and beyond a narrow circle of bankruptcy specialists, the case received little attention at the time. A Senate committee hearing room is not the place to dissect the statutory language at issue, and my students might even contest whether they should hear about it in the law school classroom. The interpretive issues in Nobelman were truly complex, and it is fair to say that there were reasonable arguments on either side of the issue.

Although fair-minded justices could reach either outcome, the Supreme Court unanimously sided with the banking interests. In doing so, the Court reached a decision that was contrary to the majority view in the lower federal courts. In doing so, the Court strengthened special advantages home lenders had managed to get in the enactment of the original Bankruptcy Code. In doing so, the Court barred relief on a modest principal residence that would be available for vacation homes or investment property. In doing so, the Court left the burden of legislative change with the consumer. The reception that Senator Durbin's bill has received gives some indication of the relative powers of banking interests and consumer interests in the legislative process. By reaching a decision in favor of banking interests, the Court essentially locked in the law and now has led to a situation where bankruptcy judges are deprived of a potentially important tool in a financial crisis.

c. Taking Away Enforcement Power of State Attorneys General

My final example comes from just the last Supreme Court term. In Watters v. Wachovia Bank, the Court deprived the state attorneys general of the power to enforce state consumer law against the operating subsidiaries of national banks. Rather than dispersed among fifty state attorneys general, the responsibility for enforcing consumer protection against national banks now rests solely with the OCC. This is the same agency that took the banking industry's side by issuing favorable regulations leading to the Smiley decision, and the same agency whose industry favoritism has been the subject of recent media attention. Why does responsibility for consumer protection now rest solely with the OCC?--because the OCC had issued regulations saying it did. The issue in Watters was whether the Court should uphold these OCC regulations, and a majority of the Court agreed that the OCC could issue regulations that defined the scope of its own authority to displace contrary state law.

Watters will be a case that consumers will feel in the years to come. Even if the OCC suddenly became interested in more strictly enforcing consumer protections, it will lack the resources and interest that fifty state attorneys general could bring. For example, before Watters, the New York attorney general had brought a proceeding to investigate overcharging by mortgage lenders. The investigation was not about fees that were too high or about debtors who were trying to escape responsibility for loans. Instead, the investigation was triggered by a modest $27,000 home loan, incurred in 1974 and paid off over 25 years. Despite its own paperwork that showed the loan had been completely paid off, the lender had collected over $9,400 in extra payments. After Watters, the New York attorney general would not be able to bring this investigation, and the affected consumer will have to turn to the OCC for whatever help it is inclined to offer.

Another example of how Watters will come to affect consumers comes from the cover story of a recent issue of Business Week. The city of San Francisco has sued the National Arbitration Forum (NAF) alleging it "is actually in the business of operating an arbitration mill, churning out arbitration awards in favor of debt collectors and against California consumers." Business Week tells the story of Laurie Raymond, an Oregon attorney who had to fight a $16,000 arbitration award from NAF. Raymond had not incurred the debt, which had to be the result of a fraud or a mistake. The credit card company at times had even admitted Raymond did not owe the money. An attorney herself, Raymond had the resources and knowledge to wage a two-year fight with the NAF. Others will not be so lucky. Because of the broad authority upheld in Watters, attempts to fight unjustified arbitration awards from credit card debt collections like that of the San Francisco city attorney will be met by claims they are precluded by federal law. Reports are even beginning to surface that some lenders are using Watters to argue they are exempt from basic state foreclosure laws.

II. Why Business Tends to Win

These cases illustrate the tilted playing field in favor of big business. No one would seriously suggest that the justices sit down in a back room and consciously decide to be "pro-business" or "anti-consumer." Instead, these results come more from a litigation system that produces systematic advantages for big business by the time cases get to the highest court in the land.

In the financial services area with which I am most familiar, the cases that make it to the Supreme Court typically involve very technical and complex statutory schemes in which the justices are unlikely to have had a deep background prior to assuming the bench. Moreover, the justices are unlikely to come to the Court with deeply held ideological convictions on the proper scope of the chapter 13 cramdown--as was at issue in Nobelman--or the preemptive scope of the National Bank Act--as was at issue in Marquette and Smiley. Unanimity (or near unanimity) in these cases often will reflect these realities. An individual justice does not have much to gain from being a lone dissenter on the meaning of five words in section 85 of the National Bank Act and can gain more by trading votes or joining an opinion to display collegiality that later might be severely tested by a dissent in a higher-profile decision.

For these reasons, Supreme Court litigation is especially susceptible to the dynamics of litigation and the regulatory process that especially help big business. In my areas of specialty, I see two inescapable parts of the institutional structure that play a role. First, on a highly technical regulatory issue, the position of the agency involved or the brief of the Solicitor General often sways the outcome in the Supreme Court. Second, because they often will be simultaneously litigating the same issue in dozens of the same cases, a big business like a credit card company can choose to take to the Supreme Court whichever case has facts that present its position in the best possible light.

As part of the Department of Justice, the Solicitor General's views will come and go with changes in administrations. An administration with a tin ear toward the concerns of consumers is likely to have a Solicitor General with similar views. Even beyond the ideological slant of any particular Solicitor General, that officer is charged with protecting the interests of the United States, and as a tax collector and creditor to many Americans, the Solicitor General often will see the interests of the United States as consonant with the interests of financial institutions. There is particular reason to believe this happens in bankruptcy cases, where the United States has appeared in the Supreme Court often to protect its interest as a creditor (generally a tax creditor). As to agencies, it is an inescapable fact of the modern administrative state that they will come to identify with the industries they regulate. One need look no further than the examples of Smiley and Watters for friendly regulatory interpretations that were particularly persuasive to the Supreme Court.

As to the repeat player effect, one would hardly expect anything different from the expert and high-priced legal advice large business can command. In my work, I have found not only that institutional creditors are more able to get the Supreme Court to hear their cases in the bankruptcy area but that the same is also true for the state and federal

governments. Although there are undoubtedly multiple explanations, one commonality among these institutional creditors, state governments and the federal government as litigants is that they all are likely to have multiple disputes on the same issue. Repeat litigants, such as big consumer lenders, always can be expected to choose which case is the one they will take on appeal to the Supreme Court and can be expected to choose the case where they expect they will win. It also is worth noting that once they get to the Supreme Court, business interests will be able to call on far more resources than consumer interests on the other side of the courtroom.
It is not that financial interests will always win every case, and consumers always are doomed to lose. Rather, it is matter of the deck being stacked. Big business will tend to win, and consumers will tend to lose. The result will be more of what we have seen--decisions immunizing financial institutions from state control, decisions tearing down consumer protections states have enacted for their own citizens, and decisions that free financial institutions to charge what rate, fee, or penalty they dare.

III. Solutions

One solution is for consumers to pay closer attention to what happens at the Supreme Court. This hearing is a useful step and will help draw attention to the many ways the Supreme Court's financial services decisions affect the everyday lives of Americans. These decisions, however, always will come from cases that appear to present mundane, dry, and technical regulatory issues, meaning these decisions will fare poorly in the competition for attention among the blare of other media stories. The diffusion of information made possible by the Internet has helped. I am continually heartened by the many persons who write into our Credit Slips blog to offer their own comments on legal and regulatory issues of the day, but our audience is still a specialized audience of persons who are particularly interested in the financial services issues we discuss. On a good day, we reach a few thousand, while news coverage on the hot button social issues that reach the Supreme Court will reach millions.

A more permanent solution might be for Congress to help even the playing field. All of the cases discussed above involved tough interpretive issues of technical statutory language where reasonable arguments could be made on either side of the case. We have seen that agency positions or systematic advantages tipped the statutory ambiguities in favor of businesses and against consumers. To even the playing field, Congress might adopt an interpretive rule that any ambiguity in a statute should be resolved in favor of consumer interests. This rule would place the burden of legislative change on the party most able to affect that change. When the Supreme Court decides an ambiguity in favor of financial interests, the practical result is that the rule is now locked in, given the advantages financial interests enjoy in the legislative process. Financial interests can and will lobby Congress to overturn statutory decisions, but consumer groups have less ability to organize and affect the legislative process. Moreover, interpreting rules that tip statutory ambiguities in one direction or another are hardly unprecedented. For example, the courts have a long tradition of resolving statutory ambiguities to avoid constitutional issues or resolving ambiguities in criminal statutes in favor of the accused. An interpretive rule that ambiguities should be resolved in favor of consumers could be enacted as a blanket rule or on a statute-by-statute basis. It would go a long way to helping alleviate some of the concerns expressed at this hearing.

1 See Robert M. Lawless, Bankruptcy in ENCYCLOPEDIA OF THE SUPREME COURT OF THE UNITED STATES, forthcoming 2008; Robert M. Lawless, Marquette National Bank v. First of Omaha Service Corp., in ENCYCLOPEDIA OF THE SUPREME COURT OF THE UNITED STATES, forthcoming 2008; Robert M. Lawless & Dylan Lager Murray, An Empirical Analysis of Bankruptcy Certiorari, 62 MO. L. REV. 101 (1997) ; Robert M. Lawless, Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases, 47 SYRACUSE L. REV. 1 (1996); Charles J. Tabb & Robert M. Lawless ,Of Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court, 42 SYRACUSE L. REV. 823 (1991). The Credit Slips blog can be found at http://www.creditslips.org.

2 See Comments of Michael L. Rosado to Proposed Regulation AA, available at http://www.federalreserve.gov/SECRS/2008/May/20080527/R-1314/R-1314_730_1.pdf (May 19, 2008).

3 Maryland Code, Commercial Law § 12-903.

4 439 U.S. 299 (1978).

5 See Bob Lawless, "One to Lie Awake at Night About," Credit Slips (May 14, 2007) (http://www.creditslips.org/creditslips/2007/05/one_to_lie_awak.html).

6 12 U.S.C. § 85.

7 See Government Accountability Office, Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers, at 18 (September 2006)

8 517 U.S. 735 (1996).

9 See Smiley, 517 U.S. at 739-45.

10 Michael Grynbaum, "Nearly 1 in 10 Homeowners Face Loan Problems," N.Y. Times, June 6, 2008 (available at http://www.nytimes.com/2008/06/06/business/06mortgage.html?hp).

11 508 U.S. 324 (1993).

12 127 S. Ct. 1559 (2007).

13 E.g., Zvika Krieger, "The Nefarious Bureaucrat Who's Helping Banks Rip You Off," The New Republic, July 2, 2007, at 14.

14 Robert Berner and Brian Grow, "Banks vs. Consumers (Guess Who Wins)," Business Week, June 5, 2008 (available at http://www.businessweek.com/magazine/content/08_24/b4088072611398.htm).

15 Sam Zuckerman, "S.F. Sues Credit Card Service, Alleging Bias," S.F. Chron., Apr. 8, 2008 (available at http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2008/04/08/BU2S101CV2.DTL).

16 See Elizabeth Warren, "Banks: State Laws Not for Us," Credit Slips (available at http://www.creditslips.org/creditslips/2008/05/banks-state-law.html).

17 Ronald J. Mann, The Supreme Court, The Solicitor General and Bankruptcy: BFP v. Resolution Trust Corp. in Bankruptcy Law Stories (Robert K. Rasmussen ed. 2007).

18 See Robert M. Lawless & Dylan Lager Murray, An Empirical Analysis of Bankruptcy Certiorari, 62 MO. L. REV. 101 (1997).