

Empowering Subprime Borrowers: Mandatory Unsecured Credit Payoffs as Finance Charges

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INTRODUCTION

Predatory lending law combines imprecise, policy-driven standards with technical, closely crafted regulations.¹ This discussion touches on both the theoretical and technical aspects of the law. In the narrow context, this Note argues that when a lender forces a borrower to pay off unsecured, third-party loans as a condition of receiving a refinanced or home equity mortgage loan, the amount of that payoff should count as a finance charge. In the broad context, it arrives at this conclusion by illustrating a connection between predatory lending statutes. This connection is significant, as predatory tactics remain prevalent in an expanding subprime market.²

Mortgage debt is a risky undertaking that changes borrowers' lives.³ Despite the risk inherent in mortgage lending, especially for those with poor credit histories,⁴ borrowers

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1. For a discussion of the Federal Trade Commission's unfairness standard, see *infra* notes 23–39 and accompanying text. For a discussion of the recent predatory lending statutes and federal regulations, see *infra* notes 129–159 and accompanying text.

2. Subprime borrowers are those who, due to income uncertainty, blemished credit, or no credit, are not eligible for a conventional loan package. "Subprime loans are significantly more expensive than prime loans to borrowers, both in terms of interest rates and points and fees." Kurt Eggert, *Held Up in Due Course: Predatory Lending, Securitization, and the Holder in Due Course Doctrine*, 35 CREIGHTON L. REV. 503, 573 (2002).

The subprime market has grown at a faster rate than the remainder of the lending market. *Id.* at 576. "Between 1993 and 1998, subprime mortgage refinancing grew from fewer than 100,000 loans to more than 800,000, while refinancing from prime lenders barely increased." *Id.* (citation omitted).

3. Professor Willis R. Bryant, in his mid-century guide for mortgage lenders, acutely captures the import of mortgage lending: "An application for a home loan is usually the largest financial undertaking in the life of the average homeowner, and great care must be exercised in analyzing the financial aspects of the transaction . . ." WILLIS R. BRYANT, *MORTGAGE LENDING* 95–96 (2d ed. 1962).

4. The drastic increase in foreclosure rates, especially in the subprime lending market, illustrates the dangers inherent in mortgage lending. See Janet Kidd Stewart, *Costly Loans Fuel Foreclosure Wave: Study Says Filings Up 74% in 8 Years; Minorities Hit Hard*, CHI. TRIB., Feb. 27, 2003, at N1 (discussing the 500% increase in foreclosures in Chicago's subprime market); see also Kristina Shevory, *More Homeowners Selling Houses for Less than They Owe*;

still disregard some mortgage charges. Even an additional \$200 added to a refinanced mortgage debt causes a large financial impact. Over a thirty-year term, an added \$200 will quadruple if financed at a 15% fixed annual rate.⁵ Borrowers should analyze closely any practice that adds even a seemingly insignificant sum to the mortgage debt.

When a lender forces a borrower to pay off small, third-party debts as a condition of receiving credit,⁶ the additional charge may seem negligible in comparison to other mortgage charges, such as interest. The lender will give the borrower capital to pay off other creditors, and this relatively small sum is then consolidated into the much larger mortgage principal.⁷ Although the lender forces the payoff, some borrowers do not challenge the requirement, finding that this requirement makes their credit payments more convenient. Instead of writing checks to several different lenders, the mortgagor need only pay the mortgagee.

These seemingly innocuous payoffs, however, convert the mortgagor's unsecured and often unfinanced debts into financed debts secured to her home.⁸ As illustrated below, this conversion places a hefty burden on the borrower that outweighs the benefits of loan consolidation.⁹

Mortgage Delinquencies Have Risen Dramatically; 'People Are in over Their Heads' with Payments, SEATTLE TIMES, Oct. 7, 2003, at A1, available at LEXIS, News Library, Seattm File; Jim Weiker, *Pace Quickens on Foreclosures; Ohio Rate Nearly Tops in Nation; Economy, Lending Habits Blamed*, COLUMBUS DISPATCH, Mar. 25, 2003, at 1D, available at LEXIS, News Library, Coldis File; see generally Letter from Margot Saunders, Managing Attorney, National Consumer Law Center, to the Honorable Michael Oxley, Financial Services Committee Chairman, U.S. House of Representatives and the Honorable Barney Frank, Financial Services Committee Ranking Member, U.S. House of Representatives (Dec. 1, 2003) (discussing the increasing national foreclosure rate caused by subprime mortgages), at http://www.consumerlaw.org/initiatives/predatory_mortgage/oxley_letter.shtml.

5. Fifteen percent is not an uncommon interest rate in the subprime market. See generally CONSUMERS UNION, ELDERLY IN THE SUBPRIME MARKET 3-4 (2002) (recounting as normal cases in which one person in the subprime market had a 14% interest rate and another had a rate of almost 16%), at <http://www.consumersunion.org/pdf/elderly-sub.pdf>. The total payment for an additional \$200 is \$903.20:

Amount Added to Principle	Total Interest	Total Payment
\$200 at 15% annual rate	\$703.20	\$903.20

6. I am thinking of debts such as cell phone bills, utility bills, and small judgments. While these debts are not small to those who cannot pay them off, they do not compare in magnitude with mortgage debt.

7. For a discussion concerning the common traits of forced credit payoffs, including the consolidation of the payoff sums with the borrower's mortgage debt, see *infra* note 11. In some instances, of course, the borrower can simply pay the debts without the lender's help; therefore, the payoff amount is not consolidated onto the debt. But as my discussion with Jim Sugarman suggests, see *infra* note 11, this self-payoff does not often occur in the subprime market because of the borrower's limited finances.

8. Credit card payoffs provide a typical example of a forced payoff of a *financed* debt. Even though *some* of the unfairness arguments this Note presents only apply to the payoff of unfinanced debt, it still asserts that forced payoffs of financed debt are unfair because the payoff transforms the unsecured debt into a secured debt. See *infra* notes 77-88 and accompanying text. Importantly, the scope of my argument is limited to small credit card payoffs.

9. See *infra* notes 86-99 and accompanying text.

Furthermore, these costly payoffs are common. The National Consumer Law Center's *Truth in Lending* notes: "It is fairly common for creditors to require that the consumer pay other debts as a condition of obtaining the loan."¹⁰ Lenders in the subprime market often require these payoffs before they will refinance a mortgage or sell a home equity loan.¹¹ Due to the financial harm this common practice causes borrowers, advocates should consider remedies available in federal consumer protection statutes.

This Note contends that federal law can provide a remedial course for subprime borrowers forced to pay off unsecured third-party debts as a condition of a refinanced or home equity mortgage loan. In order to simplify the discussion, these forced payoffs are called "unsecured credit payoffs" throughout the Note.¹² The argument proceeds as follows: (1) Unsecured credit payoffs fit the definition of an "unfair trade practice" under the Federal Trade Commission ("FTC") Act;¹³ (2) because the FTC has not regulated this practice and because the FTC Act provides no private avenue to remedy the unfairness, borrowers should seek a remedy in other statutes;¹⁴ (3) an unsecured credit payoff fits the statutory definition of a finance charge under the Home Ownership and Equity Protection Act ("HOEPA") (by classifying the payoff sum as a HOEPA finance charge, a court could supply an avenue to remedy the unfairness;

10. ELIZABETH RENUART & KATHLEEN E. KEEST, NATIONAL CONSUMER LAW CENTER, *TRUTH IN LENDING*, § 3.6.1.2, at 88 (4th ed. 1999).

11. According to Jim Sugarman, an attorney with the AARP's Legal Counsel for the Elderly:

Most of my clients are required to pay off even their unsecured consumer debts with a refinance loan. . . . The borrower is not informed which debts are being paid until those debts are listed on the HUD-1 settlement statement If they do know that other debts are being paid, they are told that this debt consolidation is in their financial interest.

E-mail from Jim Sugarman, Legal Counsel, AARP, to Steven R. Sharpe (Nov. 19, 2003, 10:35:19 EST) (on file with author). Commentators have also noted the common nature of this practice in the refinancing context. See Odette Williamson, *Protecting Elderly Homeowners from Predatory Mortgage Lenders*, 34 CLEARINGHOUSE REV. 297, 302 (2000) (discussing "refinancing unsecured debt" as a common predatory lending practice). For a description of the subprime market, see *supra* note 2.

The lender's actions at issue in *Thorp Loan & Thrift Co. v. Buckles (In re Buckles)*, 189 B.R. 752 (Bankr. D. Minn. 1995), illustrate how borrowers end up making these payoffs. Although the borrower in *Buckles* never contemplated paying off her JC Penney's account through her mortgage, the lender found out about the preexisting debt through a questionnaire. *Id.* at 756. "[The lender] induced the Debtor to agree to obtaining this component of the advance; the Debtor did not ask for it, and had never contemplated receiving it." *Id.* at 757.

12. I also employ the term "unsecured credit payoffs" to distinguish between credit payoffs that do not involve collateral, which are the subject of this Note, and payoffs in which the lender forces the payment of third-party liens on the collateral. The latter type of credit payoffs is not considered unfair and is not considered a "finance charge" under the federal regulations. *Smith v. Fidelity Consumer Disc. Co.*, 898 F.2d 896 (3d Cir. 1990).

13. See *infra* notes 40-113 and accompanying text.

14. See *infra* notes 113-24 and accompanying text.

however, courts have not yet addressed this issue¹⁵); (4) the unremedied unfairness (as defined by the FTC Act) that borrowers forced into unsecured credit payoffs face should provide judges a sufficient policy incentive to classify the payoffs as HOEPA finance charges;¹⁶ and (5) therefore, the HOEPA framework can provide the borrower a private remedial course that the FTC Act lacks.¹⁷

The HOEPA-FTC Act link illustrated in this Note has relevance beyond unsecured credit payoffs. Plaintiffs in other contexts can utilize the strong connections between HOEPA and the FTC Act in order to strengthen their predatory lending claims. Accepting this argument, however, will not lead to a slippery slope where all potentially unfair practices will produce finance charges. Unsecured credit payoffs *already* meet the definition of a finance charge. The HOEPA-FTC Act argument simply provides judges with an incentive to follow the definition in the absence of any on-point precedent.

I. UNSECURED CREDIT PAYOFFS—A HYPOTHETICAL

To illustrate the impact of unsecured credit payoffs, this Note employs a hypothetical situation drawn from an actual case.

Ms. Smith, a sixty-year-old woman, decided to refinance her mortgage. She had held an 8% fixed-interest loan. However, after refinancing her mortgage, her interest rate climbed to 13%. Moreover, as a condition of the refinancing, the lender forced her to pay off a \$600 wireless phone bill, a \$200 judgment debt,¹⁸ and a \$200 electricity bill. The lender consolidated these amounts into her debt after paying off her creditors. Each debt was previously unfinanced and unsecured.¹⁹ This Note employs this fact pattern below in order to illustrate the unfair elements of unsecured credit payoffs.

15. See *infra* notes 129–91 and accompanying text. Much, if not all, of the argument presented should apply to the characterization of unsecured credit payoffs in non-HOEPA Truth in Lending actions, especially in the mortgage lending context. See *supra* notes 129–32 and accompanying text. Because this Note focuses solely on subprime mortgage lending, however, the discussion will be limited to HOEPA.

16. See *infra* notes 192–213 and accompanying text. I am not arguing that fees charged in connection with the payment of a loan, like a prepayment penalty, should count as a finance charge. See *Stutman v. Chemical Bank*, 94 Civ. 5013 (MBM), 1996 WL 539845 (S.D.N.Y. Sept. 24, 1996) (finding that a prepayment penalty is not a finance charge).

17. See *infra* note 191 and accompanying text. It is important to note, however, that the FTC could always remedy the unfairness under its enforcement power under the FTC Act. As I noted, the agency has not considered unsecured credit payoffs.

18. In this case, the woman paid off this debt despite being judgment-proof. In Indiana, a judgment creditor automatically gains a lien on the debtor's real property once the decision is docketed. See, e.g., IND. CODE § 34-55-9-2 (1998); see also 46 AM. JUR. 2d *Judgments* § 371 (1994) ("A judgment lien ordinarily is not a lien on any specific real estate of the judgment debtor but is a general lien on all of the debtor's real property."). However, because Ms. Smith did not hold non-exempt equity in her real property (or any other non-exempt property), according to the Indiana exemption statute, IND. CODE § 34-55-10-2 (1998), the judgment creditor could not recover that \$200 debt. Yet, she still was forced to pay off the \$200.

19. This summary is simplified in order to facilitate easy calculation. The actual facts of this case are much worse. The prime borrower in the actual case did not owe the debt;

II. THE UNFAIRNESS OF UNSECURED CREDIT PAYOFFS

A. *The FTC Act and the FTC's Policy Against Unfair Practices*

In 1938, Congress broadened the scope of the FTC Act,²⁰ a statute that provides government agencies the power to punish entities engaged in illegitimate commercial practices. Prior to the 1938 amendment, the FTC Act invalidated only "unfair methods of competition."²¹ The revised statute made "unfair or deceptive acts or practices in and affecting commerce" unlawful.²²

The FTC Act evaluates potential "unfair" acts using a different standard than the one used to evaluate potentially "deceptive" acts.²³ In other words, an agency may find a practice unfair but not deceptive. This Note is concerned only with the scope of the unfairness standard.²⁴

Congress split the regulatory power of the FTC Act among several governmental bodies. It provided the Federal Trade Commission the chief authority to punish entities engaged in unfair trade practices.²⁵ The legislature, however, reserved the power to curb unfair practices in the banking industry to the federal agencies that regulate banks.²⁶ Moreover, after the relevant agency adjudicates the unfairness of a practice, the defendant may appeal in federal court.²⁷

instead, the borrower's thirty-year-old daughter held the debt. The daughter was simply planning to drive her mother to the lender's office to finalize the deal. However, when she arrived, the lender convinced her not only to cosign the debt, but also to include her outside debts in the loan amount. Furthermore, the amount of the third-party debt added up to well over \$1000.

20. Federal Trade Commission Act, ch. 49, 52 Stat. 111 (1938) (codified as amended at 15 U.S.C. §§ 41, 44, 45, 52–58 (2000)).

21. *Am. Fin. Servs. Ass'n v. FTC*, 767 F.2d 957, 965–67 (D.C. Cir. 1985) (discussing the legislative history of the FTC Act).

22. 15 U.S.C. § 45(a)(1). This particular section of the United States Code is also commonly referred to as Section 5(a) of the FTC Act. *Am. Fin. Servs.*, 767 F.2d at 972. After the amendment, the Supreme Court, in *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972), validated the ability of the Federal Trade Commission and other agencies to determine whether or not a particular act was sufficiently unfair or deceptive to lead to a penalty.

23. The Federal Trade Commission has promulgated policy statements that attempt to shed light on each term. In 1980, it released a policy statement that set out the factors for an "unfair" practice. Policy Statement on Consumer Unfairness, 4 Trade Reg. Rep. (CCH) ¶ 13,203 (Dec. 17, 1980) [hereinafter 1980 Policy Statement]. In 1983, it released a policy statement describing deceptive acts. Policy Statement on Deceptive Acts and Practices, 4 Trade Reg. Rep. (CCH) ¶ 13,205 (Oct. 14, 1983). In 1984, the agency officially adopted the unfairness policy statement in the context of an agency decision. See *In re Int'l Harvester Co.*, 104 F.T.C. 949, 1060 (1984); see also Roger E. Schechter, *The Unfairness of Click-On Software Licenses*, 46 WAYNE L. REV. 1735, 1764–65 (2000).

24. For an extensive discussion of the history behind the FTC Act and the genesis and evolution of the FTC's unfairness power, see Schechter, *supra* note 23, at 1759–66. See also Ernest Gellhorn, *Trading Stamps, S & H, and the FTC's Unfairness Doctrine*, 1983 DUKE L.J. 903 (1983); David A. Rice, *Consumer Unfairness at the FTC: Misadventures in Law and Economics*, 52 GEO. WASH. L. REV. 1 (1983).

25. 15 U.S.C. §§ 45(a)(2), 57(a)-(e).

26. *Id.* §§ 45(a)(2), 57(g). There are several federal agencies that regulate banks in the United States. The Federal Reserve regulates state-chartered banks that are members of the

Despite this split in power, agencies and courts have not burdened lawyers with incongruous definitions of unfairness. The entities each analyze unfairness under a common approach; they rely on the framework established by the 1980 FTC Policy Statement.²⁸ The consistency in the unfairness standard across agencies prevents undue confusion.

Although the government agencies and courts use the same concepts to evaluate unfairness, the enumerated standards do not provide clear-cut rules. Professor Calkins succinctly explains this point:

The Supreme Court has not spoken. No new court of appeals has weighed in. No opinion of the Commission addresses FTC Act Section 5(n). The Commission has not based any new Trade Regulation Rule on the unfairness authority

In part due to the dearth of binding precedent, the law of FTC unfairness remains indeterminate. . . . Observers recognized that the 1980 Unfairness Statement, while a significant analytic contribution, failed to draw bright lines delineating unfair practices²⁹

Despite its vagueness, the 1980 FTC Policy Statement still anchors any unfairness analysis. The FTC issued its statement as a letter addressed to the Consumer Subcommittee of the Senate Committee on Commerce, Science, and Technology.³⁰ After studying the FTC Act jurisprudence, the FTC found that it was able to isolate the factors used to determine unfairness.³¹

Federal Reserve System. The Office of the Comptroller of the Currency ("OCC") regulates national banks. Finally, the Federal Deposit Insurance Corporation ("FDIC") regulates insured state banks that are not part of the Federal Reserve System. OCC, Public Information, at <http://www.occ.treas.gov/pubinf.htm> (last visited Aug. 30, 2004).

27. For a discussion concerning the interplay between the agencies and the courts, see Stephen Calkins, *FTC Unfairness: An Essay*, 46 WAYNE L. REV. 1935, 1947–50 (2000).

28. See 1980 Policy Statement, *supra* note 23. All involved entities, including the FDIC, OCC, FTC, and the Federal Reserve, have consistently used the same three-factor definition for unfairness. See Guidance on Unfair or Deceptive Acts or Practices, 6 Fed. Banking L. Rep. (CCH) ¶ 64-122 (Mar. 22, 2002) (using the three-factor test outlined by the FTC's policy statement). The Federal Reserve Board has consistently cited the FTC's policy statement on unfairness as authoritative. Letter from Alan Greenspan, Chairman of the Federal Reserve, to Congressman John J. LaFalce, Ranking Member of the House Committee on Financial Services (May 30, 2002), <http://www.federalreserve.gov/boarddocs/press/bcreg/2002/20020530/attachment.pdf> (last visited Jan. 14, 2005).

29. Calkins, *supra* note 27, at 1960–61 (internal footnotes omitted); see also Schechter, *supra* note 23, at 1770–72 ("The concept of 'injury' in the law of unfairness is surprisingly underdeveloped.").

30. See 1980 Policy Statement, *supra* note 23, at ¶ 20,907 ("Rather than merely reciting the law, we have attempted to provide the Committee with a concrete indication of the manner in which the Commission has enforced, and will continue to enforce, its unfairness mandate.").

31. *Id.* at ¶ 20,908. The agency fit its important summary squarely within the boundaries of prior Supreme Court cases. See, e.g., *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 249 (1972).

The FTC's statement emphasized the role of consumer injury as the primary indicator of an "unfair practice."³² Prior to the policy, consumer injury was one factor, among others, in an unfairness analysis.³³ The FTC, however, recognized a shift in the concept of unfairness. "Unjustified consumer injury is the primary focus of the FTC Act By itself it can be sufficient to warrant a finding of unfairness."³⁴ The contemporary unfairness jurisprudence focuses solely on a finding of consumer injury.³⁵

This emphasis on consumer injury led to the development of the three-prong test for unfairness that courts and agencies now uniformly employ.³⁶ In fact, Congress has explicitly codified the three-prong standard into the FTC Act.³⁷ While neither the Federal Reserve nor the FTC has promulgated regulations that explicitly define specific mortgage lending practices as unfair,³⁸ the agencies apply the FTC Act's three-prong unfairness test in the home lending area.³⁹

B. Unsecured Credit Payoffs Satisfy the Three-Prong Test for FTC Act Unfairness

To constitute an unfair practice under the FTC Act, the consumer injury must satisfy three requirements: "[The injury] must be substantial; it must not be outweighed by any countervailing benefits to consumers or competition that the practice produces; and it must be an injury that consumers themselves could not reasonably have avoided."⁴⁰ The injury caused by unsecured credit payoffs sufficiently satisfies each prong of the FTC test.

32. See 1980 Policy Statement, *supra* note 23, at ¶ 20,908-09.

33. *Id.* at ¶ 20,908. The three factors for unfairness were "(1) whether the practice injures consumers; (2) whether it violates established public policy; (3) whether it is unethical or unscrupulous." *Id.* (internal footnotes omitted).

34. *Id.* The FTC also deemphasized the two other factors, basically leaving consumer injury as the main ingredient for a finding of unfairness. See Calkins, *supra* note 27, at 1953-55.

35. See Schechter, *supra* note 23, at 1765 (discussing the primacy of "consumer injury").

36. See, e.g., *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354, 1364-65 (11th Cir. 1988) (discussing in detail the three-prong status and the primacy of the "consumer injury" factor).

37. Federal Trade Commission Act Amendments of 1994, Pub. L. No. 103-312, 108 Stat. 1691 (codified at 15 U.S.C. § 45 (2000)).

38. The agencies have promulgated rules governing credit practices in the non-real estate context. See *Unfair or Deceptive Acts or Practices (Regulation AA)*, 12 C.F.R. pt. 227 (2004) (governing credit practices in the banking industry); *Credit Practices*, 16 C.F.R. pt. 444 (2004) (governing credit practices in the remaining contexts). These regulations provide the detail and clarity absent in the mortgage lending context. See *Letter from Alan Greenspan to John J. LaFalce*, *supra* note 28, at 2-3 (discussing the Federal Reserve Board's decision not to promulgate explicit regulations for unfairness in mortgage lending).

39. See, e.g., *Supervisory Guidance on Predatory Lending Practices*, 6 Fed. Banking L. Rep. (CCH) ¶ 64-125 (Feb. 21, 2003) (discussing the FTC Act's applicability to abusive mortgage loans).

40. See 1980 Policy Statement, *supra* note 23, at ¶ 20,908; see also 15 U.S.C. § 45(n).

It is important to recognize at the outset, however, that this analysis will vary somewhat from the FTC's standard case-by-case analysis.⁴¹ Normally when the FTC engages in the three-prong analysis, it evaluates a single fact pattern. While this case-by-case analysis is necessary to determine whether a particular entity should face a sanction, the context of this Note requires an analysis independent from a specific controversy. Rather than focusing on the actions of a particular corporation, it uses this three-part test to demonstrate the unfair elements that inhere in unsecured credit payoffs. The hypothetical situation outlined above is employed in order to avoid an entirely abstract analysis.

1. The Practice Causes Substantial Consumer Injury

For a practice to be deemed unfair, it must cause consumers substantial injury.⁴² The magnitude of the injury is measured from an objective standpoint and typically involves a consumer's financial loss.⁴³ "In most cases a substantial injury involves monetary harm, as when sellers coerce consumers into purchasing unwanted goods or services . . ."⁴⁴ Simply put, "[t]o qualify as substantial, an injury must be real, and it must be large compared to the offsetting benefits."⁴⁵

An early D.C. Circuit case, reviewing an FTC action, discussed various types of injury that courts consider in the "substantial injury" inquiry. In *American Financial Services v. FTC*,⁴⁶ the agency challenged two of the defendant's credit practices as unfair. First, the defendant required consumers to "give a non-possessory security interest in their household goods and personal effects" in exchange for credit.⁴⁷ This practice, while providing limited economic security to the creditor, had devastating economic and psychological effects on the debtor.⁴⁸ For instance, it allowed the creditor to exploit the debtor's emotional connection to his goods and, consequently, coerce the debtor into accepting the creditor's terms.⁴⁹

Second, the defendant imposed wage assignments that allowed it to receive all or a portion of the debtor's wages directly from his employer.⁵⁰ These assignments occurred

41. See Schechter, *supra* note 23, at 1770 (discussing the general approach of the FTC in evaluating unfairness in trade).

42. 1980 Policy Statement, *supra* note 23, at 20,908.

43. J. Howard Beales, III, FTC's Use of Unfairness Authority: Its Rise, Fall, and Resurrection (unpublished manuscript), at www.ftc.gov/speeches/beales/unfair0603.htm (last visited Sept. 4, 2004). Beales is the director of the Bureau of Consumer Protection at the Federal Trade Commission. *Id.* While his article does not officially state the positions of the FTC, it provides a strong insight into the history and use of the test. I will utilize this work throughout this Note.

44. 1980 Policy Statement, *supra* note 23, at ¶ 20,908.

45. Beales, *supra* note 43 (footnote omitted).

46. 767 F.2d 957 (D.C. Cir. 1985).

47. *Id.* at 973.

48. *Id.* ("While the monetary gain realized by the creditor upon seizure . . . is minimal to nonexistent, the replacement cost to the consumer is substantial, not to mention the sentimental value of the possessions and the psychological impact of the loss on the consumer.").

49. *Id.* at 974.

50. *Id.*

without a hearing; the debtor had no ability to present a defense.⁵¹ Aside from the procedural unfairness to the debtor, wage assignments had devastating effects on the debtor's economic situation.⁵² The practice caused some debtors to lose their jobs.⁵³ Furthermore, the assignments usually occurred at a time of financial hardship and "tend[ed] to cause further disruption of family finances and . . . even put at risk a wage earner's ability to provide necessities for the family."⁵⁴

In another landmark case, *Orkin Exterminating Co. v. FTC*,⁵⁵ the substantial injury flowed from the financial consequences of the challenged practice.⁵⁶ Through its policy of unilaterally breaching contracts with customers, Orkin generated more than \$7,000,000 in revenue from 200,000 breached contracts.⁵⁷ The court found that this high level of consumer loss compelled a finding of substantial injury.⁵⁸

A recent FTC enforcement action similarly focused on financial injuries. In that case, the government required a major lending entity to return \$40,000,000 to consumers.⁵⁹ The FTC attorneys charged Fairbanks Capital Corporation, one of the country's largest subprime lenders, "with engaging in a variety of unfair, deceptive, and illegal practices in the servicing of subprime mortgage loans."⁶⁰ The agency closely scrutinized Fairbanks's protocol for charging service fees.⁶¹ The complaint noted that:

Fairbanks profits from money it "advances" to the consumer to pay for items that Fairbanks deems necessary to protect its rights in the property. These "corporate advances" include fees for property inspections, demand letters, [and] broker's price options These corporate advances are added to the loan balance, and Fairbanks profits from interest charged on the advances.⁶²

51. *Id.*

52. *Id.*

53. *See id.* ("Employers are hostile to wage assignments due to added administrative costs and burdens and the fear that the employee's job motivation and performance will suffer as a result of the reduction of wages. Moreover, employers tend to view the consumer's failure to repay the debt as a sign of irresponsibility.") (citations omitted).

54. *Id.* at 975.

55. 849 F.2d 1354 (11th Cir. 1988).

56. The FTC's report stated that "[t]he harm resulting from Orkin's conduct consists of increased costs for services previously bargained for and includes the intangible loss of the certainty of the fixed price term in the contract." *Id.* at 1364-65 (quoting *In re Orkin Exterminating Co.*, 108 F.T.C. 263, 362 (1986)); *see also* Schechter, *supra* note 23, at 1771.

57. *Orkin*, 849 F.2d at 1356, 65.

58. *Id.* at 1365.

59. Press Release, Federal Trade Commission, Fairbanks Capital Settles FTC and HUD Charges (Nov. 12, 2003), at <http://www.ftc.gov/opa/2003/11/fairbanks.htm> (last visited Jan. 14, 2005) [hereinafter FTC, Fairbanks Capital Settles].

60. *Id.*

61. Complaint for Permanent Injunction and Other Equitable Relief and Monetary Civil Penalties, *United States v. Fairbanks Capital Corp.*, No. 03-12219 (D. Mass. filed Nov. 12, 2003), <http://www.ftc.gov/os/2003/11/0323014comp.pdf> (last visited Jan. 15, 2005) [hereinafter *Fairbanks*, Complaint for Injunction].

62. *Id.* at 4.

Furthermore, the agency discovered that the defendant charged late fees in an illegal manner.⁶³ The FTC alleged that the defendant violated the unfairness provision in the FTC Act by levying unwarranted servicing fees and illegal late fees.⁶⁴ The complaint further alleged that Fairbanks caused financial harm to its mortgage consumers by forcing them to purchase unnecessary insurance. “[D]efendants in numerous instances have force placed casualty insurance on consumers’ homes when such insurance was already in place.”⁶⁵ Not only was this “force placed” insurance unnecessary, but it was also more expensive than insurance purchased by the consumer.⁶⁶ The court in *Fairbanks* found a substantial harm and approved the consent order.⁶⁷

As in *Fairbanks* and *Orkin*, the substantial injury that flows from unsecured credit payoffs is a financial one. The practice damages the borrower’s finances in two ways. First, the conversion of an unfinanced sum into a financed sum substantially increases the borrower’s formerly interest-free debt. Second, the conversion of unsecured debt into secured debt beightens the risk in default.

Unsecured credit payoffs generally attach high interest rates to previously unfinanced debts.⁶⁸ Like the fees that caused substantial injury in *Fairbanks*, these debts “are added to the loan balance, and [the lender] profits from [the] interest charged.”⁶⁹ The lender extends the reach of the loan’s high interest beyond the mortgage amount and into the borrower’s unrelated debts.

The Smith hypothetical will further illustrate the depth of the borrower’s financial loss.⁷⁰ Prior to the loan agreement, Ms. Smith held \$1000 in various unsecured and unfinanced debts. The lender forced Ms. Smith to pay off those debts and, consequently, the additional \$1000 was consolidated with her financed debt. Because of this transaction, the original \$1000 debt, when financed at thirteen percent annual rate over thirty years, will transform into approximately \$4000.⁷¹ The borrower, likely unaware of the effects of the payoff, is forced to unduly pay for debts unrelated to the mortgage. The lender, therefore, not only controls the cost of its mortgage service, it also controls the cost of the borrowers’ other loans. The FTC, in its complaint in *Fairbanks*, has recognized the unfairness of this manipulation.⁷²

63. *Id.* at 5–6.

64. FTC, *Fairbanks Capital Settles*, *supra* note 59.

65. *Fairbanks*, Complaint for Injunction, *supra* note 61, at 8.

66. *Id.* at 5.

67. FTC, *Fairbanks Capital Settles*, *supra* note 59.

68. *See supra* notes 8–11 and accompanying text. Again, for those instances, like credit card payoffs, in which the debt amount was already financed before the payoff, the substantial injury flows from the transformation of unsecured debts into secured debts. *See infra* notes 73–84 and accompanying text.

69. *Fairbanks*, Complaint for Injunction, *supra* note 61, at 4.

70. *See supra* text accompanying notes 18–19.

71. At the above interest rate, Ms. Smith would have to pay \$2990.42 in interest:

Amount Added to Principle	Total Interest Cost	Total Debt
\$1000 at 13% annual rate	\$2990.42	\$3990.42

72. *See supra* notes 59–67 and accompanying text.

The unsecured credit payoffs further injure plaintiffs by securing formerly unsecured debts. The injury involved in payoffs of unsecured yet financed debts (such as credit cards) flows from this transformation. Commentators have noted that forcing a person to refinance unsecured debt is unfair and predatory.⁷³ In her analysis of predatory lending, Odette Williamson notes that lenders who suggest consolidation “do not mention that the higher debt burden increases the risk of foreclosure and the long-term costs of debt repayment.”⁷⁴

The transformation of the debts’ secured status causes three distinct injuries. First, as Williamson notes,⁷⁵ it increases the likelihood of the borrower losing her house through foreclosure. When the borrower’s unsecured, third-party debts are added to the loan, the formerly unsecured sum becomes part of the secured mortgage debt. Before the transaction, the borrower’s third-party, unsecured debt was not tied to any particular asset.⁷⁶ However, once the debt becomes secured, a relationship is formed between the added debt and the collateral (namely, the borrower’s home).⁷⁷ If the borrower defaults on this formerly unsecured sum, as part of the mortgage debt, the creditor can reach the home. By increasing the amount of secured debt attached to her home, the transformation “increases the [borrower’s] risk of foreclosure.”⁷⁸

Second, the transformation of the debts to secured status makes the debtor more susceptible to collection on those debts than before the transformation. An unsecured creditor has limited collection ability.⁷⁹ “The unsecured creditor’s path to payment is narrow. Not only does the law provide procedures for the collection of unsecured debts, it regulates or bars outright many alternatives.”⁸⁰ On the other hand, the secured creditor enjoys a more powerful position. The secured creditor does not have to hunt for sufficient assets like an unsecured creditor;⁸¹ rather, he can foreclose on the collateral upon the borrower’s default.⁸² Given the inequality in collection power, the borrower whose debts become secured loses a significant advantage that he had previously held over the unsecured creditor. After the change in the debts’ secured status, he is much more susceptible to collection on those debts.

Third, the borrower loses the protection of state exemption statutes. State exemption statutes classify some of a borrower’s property as exempt from collection upon default of an *unsecured* debt.⁸³ In other words, the statute sets aside some property as immune from attachment. For example, suppose the three unsecured creditors from the

73. See, e.g., Williamson, *supra* note 11.

74. *Id.* at 302.

75. *Id.*

76. LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 13–15 (4th ed. 2003) (discussing the general nature of secured transactions).

77. *Id.* at 21.

78. Williamson, *supra* note 11, at 302.

79. RAYMOND T. NIMMER ET AL., COMMERCIAL TRANSACTIONS: SECURED FINANCING CASES, MATERIALS, PROBLEMS 18 (2d ed. 1999) (“[The unsecured creditor’s] ultimate success is dicey at best.”).

80. LOPUCKI & WARREN, *supra* note 76, at 4.

81. NIMMER ET AL., *supra* note 79, at 18 (“[Success] will depend on whether the sheriff can locate sufficient nonexempt, unencumbered assets to satisfy your judgment.”).

82. LOPUCKI & WARREN, *supra* note 76, at 29.

83. These exemption statutes exist in all fifty states. *Id.* at 15.

hypothetical above attempt to collect from Ms. Smith before the mortgage agreement. Suppose further that Ms. Smith lives in Indiana and that she holds only the following assets: \$3000 in personal goods and \$4000 in home equity. Due to the Indiana exemption statute,⁸⁴ which protects up to \$4000 in personal goods and up to \$7500 in home equity from unsecured creditors, the three creditors cannot collect any part of the debt until Ms. Smith obtains some non-exempt assets. Once Ms. Smith's debts become secured, she loses this protection.

The lender that mandates unsecured credit payoffs causes substantial injury to the borrower by attaching significant interest to small, unfinanced loans and by increasing the danger inherent in those loans. This conclusion follows logically from the FTC's *Fairbanks* complaint.⁸⁵

2. The Benefits Do Not Outweigh the Substantial Injury

For a practice to classify as unfair under the FTC Act, the substantial injury must outweigh any benefits to the consumer or to the competitive market.⁸⁶ "The Commission is aware of . . . tradeoffs and will not find that a practice unfairly injures consumers unless it is injurious in its net effects."⁸⁷ The FTC primarily takes into account the practice's economic effect; however, it can also consider non-economic factors in its balancing equation.⁸⁸

As I have stated above, commentators have recognized the predatory nature of unsecured credit payoffs.⁸⁹ In line with this analysis, this Note contends that the benefits of these payoffs do not outweigh the substantial injury that the practice causes.

Opponents may argue that the consumer receives a valuable consolidation service for the additional interest he pays. It is true that the consumer might enjoy the consolidated payments. Yet, one must view this potential benefit in the full context—it was forced on the borrower by the lender. Therefore, the benefit from the consolidation does not flow from an optional term selected by the borrower in negotiations; such spin doctoring obscures the coercive nature of the practice. Moreover, the debt consolidation is costly. The consumer receives the ease of consolidation only after giving up unfinanced, unsecured debt. She does not receive the reduced interest rate offered by many loan consolidation packages, which are advertised in the media. Rather, the borrower pays a higher interest rate than before consolidation.

84. IND. CODE § 34-55-10-2 (2000).

85. FTC, *Fairbanks Capital Settles*, *supra* note 59.

86. 1980 Policy Statement, *supra* note 23, at 20,909; *see also* Beales, *supra* note 43 ("[T]he next step is to determine whether the harm is outweighed by countervailing benefits to consumers or competition.").

87. 1980 Policy Statement, *supra* note 23, at 20,909.

88. *Id.* The FTC policy statement on unfairness gives several examples of the non-economic considerations used by the FTC: "[These other considerations] include not only the costs to the parties directly before the agency, but also the burdens on society in general in the form of increased paperwork, increased regulatory burdens on the flow of information, reduced incentives to innovation and capital formation, and similar matters." *Id.* Clearly this list is not exclusive.

89. *See* Williamson, *supra* note 11, at 302.

One could also argue that unsecured credit payoffs benefit low-income borrowers in the competitive market. The practice encourages more subprime lending by reducing the risk the lenders face.⁹⁰ The payoffs reduce risk by relieving the borrower's outside debt obligations. Once the payoffs free the borrower, he can focus on paying the mortgage debt. Nevertheless, this practice does not reduce risk inherent in the borrower's third-party debt. It is true that the payoffs will cause the borrower to focus solely on the mortgage lender. The practice, however, does not alleviate the risk from the paid-off debts because the borrower still has to pay the debt amount herself. The mortgagee's payment did not relieve the mortgagor's outside obligations; the debt simply changed hands.

An advocate for the lenders' position might also claim that the payoffs reduce risk in the early, crucial stage of the mortgage period by increasing the likelihood that the borrower will make the first payments. Lenders arguably bear the most risk during the early stages of the mortgage agreement.⁹¹ Therefore, they force the credit payoffs so that the borrower has no encumbrances that may keep her from making the first mortgage payments. While these payoffs do not relieve the borrower's debt burden, the payoffs guarantee that money formerly earmarked for other creditors will be available for use early in the mortgage term. This practice will increase the likelihood of early payment and, therefore, significantly decrease the risk involved.⁹²

In practice, however, these payoffs do not free up money already earmarked for unsecured debts. The argument is premised on the assertion that the borrower's obligation to the unsecured debt in the early stages may interfere with his mortgage obligation. This premise is faulty for several reasons. First, due to the increased danger inherent in secured transactions, the borrower *already* has an incentive to pay off secured creditors before unsecured creditors, even without the credit payoffs.⁹³ The mortgage creditor can foreclose on his house; the unsecured creditor does not have such compelling collateral.⁹⁴ The unsecured creditor's comparative disadvantage in debt collection gives the borrower a further reason to pay off his secured debts before his unsecured debts.⁹⁵ He knows that the secured creditor can collect upon default. Therefore, the forced payment of unsecured debt does not provide a significantly higher likelihood of an early payment on secured debts.

90. See *supra* note 2 and accompanying text.

91. As the borrower's equity in the security increases, the risk of default decreases. Therefore, the risk of default is highest during the early stages of the mortgage loan. See ROBERT SCHAFFER & HELEN F. LADD, *DISCRIMINATION IN MORTGAGE LENDING* 16 (1981) ("Default risk . . . should decrease as the borrower's equity in the mortgaged property increases."). On the other hand, the fact that borrowers pay mostly interest in the early stages may suggest that borrowers account for the risk.

92. For instance, if the payoff amount is \$1000 and the monthly mortgage payment is \$500, it can be argued that the payoff clears up the money for two mortgage payments.

93. See *supra* notes 73-83 and accompanying text.

94. LOPUCKI & WARREN, *supra* note 76, at 22 ("The recognition of enhanced collection rights for secured creditors necessarily diminishes the effectiveness of the collection rights of general unsecured creditors.").

95. *Id.* at 21-22.

3. The Injury is Not Reasonably Avoidable

A practice is not unfair unless the consumer could not have reasonably avoided the injury.⁹⁶ The FTC generally assumes it should not act against the decisions of consumers and that a competitive market will rid itself of most injurious practices.⁹⁷ “We anticipate that consumers will survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory.”⁹⁸ Practices that reduce an individual’s ability to choose alternatives and that withstand market forces require intervention.⁹⁹ Therefore, the FTC focuses on practices that prevent consumers from freely exercising their decisionmaking power.¹⁰⁰ For example, the FTC will aim at sellers that “engage in overt coercion . . . [or sellers that] exercise an undue influence over highly susceptible classes of purchasers.”¹⁰¹

In the subprime market, a consumer’s poor credit history diminishes his mortgage options.¹⁰² Consequently, lenders employ rates, fees, and terms that consumers in the standard credit market would not tolerate.¹⁰³ The benefits of many of these costly subprime practices outweigh the injury to the consumer. Without them, the risk inherent in the market would prevent anyone from providing credit services to subprime borrowers.¹⁰⁴ Unsecured credit payoffs, however, do not provide lenders risk protection that outweighs the injury to consumers.¹⁰⁵ Yet, despite the financial injury flowing from forced payoffs,¹⁰⁶ unsecured credit payoffs are still common in the subprime market.¹⁰⁷ Because borrowers stuck in subprime have limited options, lenders

96. 1980 Policy Statement, *supra* note 23, at 20,909; *see also* Beales, *supra* note 43 (“[T]he concept of reasonable avoidance keeps the Commission from substituting its paternalistic choices for those of informed customers.”).

97. 1980 Policy Statement, *supra* note 23, at 20,909.

98. *Id.*

99. *Id.*; *see also* Beales, *supra* note 43 (“If consumers could have made a different choice, but did not, the Commission should respect that choice.”).

100. 1980 Policy Statement, *supra* note 23, at 20,909; *see also* Beales, *supra* note 43 (“The primary purpose of the Commission’s modern unfairness authority continues to be to protect consumer sovereignty by attacking practices that impede consumers’ ability to make informed decisions.”).

101. 1980 Policy Statement, *supra* note 23, at 20,909.

102. Eggert, *supra* note 2, at 573–74.

103. *Predatory Mortgage Lending: The Problem, Impact, and Responses: Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs*, 107th Cong. 250–52 (2001) (testimony of John A. Courson, President and CEO, Central Pacific Mortgage Co., on behalf of the Mortgage Bankers Association).

104. Eggert, *supra* note 2, at 573–74 (“Lenders argue that they charge higher interest rates and fees for subprime loans because of the increased risk characteristics of subprime borrowers.”).

105. *See supra* notes 86–95 and accompanying text (discussing the balancing of benefits).

106. *See supra* notes 42–85 and accompanying text.

107. *See* RENUART & KEEST, *supra* note 10, at 89; *see also* Williamson, *supra* note 11, at 302. For an in-depth discussion of the persistence of predatory lending practices in the marketplace (including unsecured credit payoffs), *see* Kathleen C. Engel & Patricia A. McCoy,

have no incentive to stop mandating unsecured credit payoffs. The market will not eliminate unsecured credit payoffs by itself, and this practice cannot be reasonably avoidable to consumers.

In *American Financial Services Inc. v. FTC*,¹⁰⁸ the D.C. Circuit Court forcefully depicted the unavoidable nature of certain injurious credit practices in the high-risk, subprime arena. The challenged consumer finance company required two harmful contract terms of its prospective borrowers: wage assignments and a security interest in household goods.¹⁰⁹ Recognizing the difficult position of people in the high-risk lending market, the court found the practices reasonably unavoidable:

As noted, standard form contracts are presented on a take it or leave it basis. While there are differences in the kinds of contracts offered by different creditors, certain creditors, namely finance companies serving higher-risk borrowers, are most likely to include HHG [household goods] security interests and wage assignments. Furthermore while the incidence of use of these provisions may differ across different regions of the country, contracts offered by creditors of a given class in local areas are often substantially identical. Given the substantial similarity of contracts, consumers have little ability or incentive to shop for a better contract.¹¹⁰

Like the high-risk borrowers in *American Financial Services*, the borrowers at issue in this Note are forced to either take the contracts with the injurious provision or leave them. Because of their subprime position, they “have little ability or incentive to shop for a better contract.”¹¹¹ The practice is not reasonably avoidable to those subprime borrowers.

Furthermore, the mandatory nature of unsecured credit payoffs illustrates the similarities between them and the unfair, reasonably unavoidable practice in *Fairbanks*. As with the unnecessary insurance required by the lender in *Fairbanks*,¹¹² these payoffs are not offered as an option for borrowers in exchange for higher rates. The borrower’s inability to meaningfully bargain amplifies his limited choices. Because unsecured credit payoffs cause substantial injury that is neither reasonably avoidable nor outweighed by countervailing benefits, the practice is unfair under the FTC Act.

C. Plaintiffs Suffering from the Unfairness of Unsecured Credit Payoffs Do Not Have an FTC Act Remedy

When an entity engages in an unfair commercial practice, the FTC Act empowers the relevant government agency to rectify the situation. “The [Federal Trade] Commission is hereby empowered and directed to prevent persons, partnerships, or corporations . . . from using unfair methods of competition . . . and unfair or deceptive

A Tale of Three Markets: The Law and Economics of Predatory Lending, 80 TEX. L. REV. 1255, 1263-64, 1280-98 (2002).

108. 767 F.2d 957 (D.C. Cir. 1985).

109. For a discussion of the injurious nature of these credit practices, see *supra* notes 46-54 and accompanying text.

110. *Am. Fin. Servs.*, 767 F.2d at 977 (internal citations omitted).

111. *Id.*

112. *Fairbanks*, Complaint for Injunction, *supra* note 61, at 4-5.

acts or practices"¹¹³ The statute further stipulates the procedures that the FTC should follow in pursuing a violation of the act.¹¹⁴

While the FTC Act does not explicitly provide government agencies the sole ability to bring an unfairness action, courts have almost unanimously held that the act does not give an individual a private right of action. Prior to the 1938 amendment, which sanctioned entities engaging in unfair trade practices,¹¹⁵ the Supreme Court denied private plaintiffs the right to bring an unfair competition action under the FTC Act in *Moore v. New York Cotton Exchange*.¹¹⁶ The court dismissed the plaintiffs' claim, stating that "[t]here is an attempt to allege unfair methods of competition, which may be put aside at once, since relief in such cases under the Trade Commission Act must be afforded in the first instance by the commission."¹¹⁷

Lower courts have extended this prohibition beyond the context of unfair competition into the realm of unfair and deceptive practices. In *Holloway v. Bristol-Meyers Corp.*,¹¹⁸ the D.C. Circuit held that "consumers and members of the public at large" could not "bring . . . private action[s] to enforce § 5 . . . of the [FTC] Act . . . which prohibit[s] unfair or deceptive acts or practices in commerce."¹¹⁹ With the exception of a single federal district court,¹²⁰ the federal courts have consistently followed the D.C. Circuit's lead.¹²¹

The FTC has not considered the fairness of unsecured credit payoffs, and consequently those injured by the practice have received no remedy. Moreover, the absence of a private right of action leaves a borrower whose lender forced such a credit payoff in an unfair lending situation with no clear remedial path. While the consumer should inform the FTC of the unfair credit practice, it is also in her best interest to inquire into alternative remedies. She should start by examining state unfairness acts or "Little FTC" acts.¹²² These statutes typically include a private right of action¹²³ and are

113. 15 U.S.C. § 45(a)(2) (2000). Congress also provided a similar power to the Federal Reserve Board and other agencies to curb unfair practices in the banking context. 15 U.S.C. § 57(a).

114. 15 U.S.C. § 45(b)-(m).

115. See *supra* notes 20-22 and accompanying text.

116. 270 U.S. 593 (1926); see Allan B. Currie, *A Private Right of Action Under Section Five of the Federal Trade Commission Act*, 22 HASTINGS L.J. 1268, 1269 (1971) (discussing the origins of the rule against a private right of action under the FTC Act). Currie claims that, at the time of *Moore*, the ruling was not as devastating to private actors because the old federal common law provided a cause of action. *Id.* However, when the federal common law was abolished by *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), the full force of this decision was felt. Currie, *supra* at 1269-70.

117. *Moore*, 270 U.S. at 603.

118. 485 F.2d 986 (D.C. Cir. 1973).

119. *Id.* at 988 (internal footnotes and quotations omitted).

120. See *Guernsey v. Rich Plan of Midwest*, 408 F. Supp. 582 (N.D. Ind. 1976) (recognizing a private right of action under the FTC Act).

121. See, e.g., *Dreisbach v. Murphy*, 658 F.2d 720 (9th Cir. 1981); *Naylor v. Case & McGrath, Inc.*, 585 F.2d 720 (2d Cir. 1978); *Freedman v. Meldy's, Inc.*, 587 F. Supp. 658, 659-60 (E.D. Pa. 1984) (discussing in detail the case law against a private right of action).

122. See generally Donald M. Zupanec, Annotation, *Practices Forbidden by State Deceptive Trade Practice and Consumer Protection Acts*, 89 A.L.R.3d 449 (1979) (discussing in depth the state statutes designed to curb unfair and deceptive acts).

often similar to the FTC Act.¹²⁴ However, the borrower should not limit herself to a state cause of action that may not exist in a particular jurisdiction and that may be construed narrowly.

The Home Ownership and Equity Protection Act (“HOEPA”) provides a potential avenue for subprime borrowers looking to remedy the FTC Act as it defined unfairness.¹²⁵ HOEPA and the FTC Act have a close logical connection as both statutes target a similar problem—predatory lending.¹²⁶ According to the Office of the Comptroller of the Currency (“OCC”), “[p]redatory lending practices [which may be unfair under the FTC Act] also may violate other laws, such as HOEPA, which covers certain high-cost mortgage loans.”¹²⁷

HOEPA provides an avenue to remedy the unfairness in unsecured credit payoffs that the FTC Act does not. However, the finding of unfairness under the FTC Act is not irrelevant. Rather, the unremedied unfairness provides judges a policy incentive to fit the practice into the HOEPA remedial framework. As explained further below, this strategy of employing a statutory violation to fit a practice into another statute is legitimate as the FTC itself used it in a case that involved both HOEPA and the FTC Act.¹²⁸

III. UNSECURED CREDIT PAYOFFS AS A HOEPA FINANCE CHARGE: PROVIDING A REMEDIAL COURSE FOR THE FTC ACT-DEFINED UNFAIRNESS

A. *The HOEPA Amendment to the Truth in Lending Act*

In 1968, Congress enacted the Truth in Lending Act (“TILA”).¹²⁹ The original TILA, which applies to almost every consumer credit transaction, requires the lender to follow a uniform disclosure framework in which the borrower can see the cost of the transaction before deciding to enter into an agreement.¹³⁰ Congress passed the law in

123. Debra A. Burke, *Cruise Lines and Consumers: Troubled Waters*, 37 AM. BUS. L.J. 689, 710–11 (2000) (“Although many of the state acts mimic the Federal Trade Commission Act . . . , unlike the federal legislation, nearly all state acts create a private cause of action for aggrieved consumers.”) (internal citations omitted).

124. See Zupanec, *supra* note 122, § 2[b], at 462 (“[C]ounsel seeking guidance [with the state acts] . . . are advised to refer to the large number of federal judicial and administrative decisions which consider the question of the lawfulness of particular acts or practices under the Federal Trade Commission Act, inasmuch as the language utilized in many state deceptive trade practice and consumer protection statutes is similar to the language of the federal act.”).

125. Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (codified as amended in scattered sections of 15 U.S.C. (2004)).

126. See, e.g., Letter from Alan Greenspan to John J. LaFalce, *supra* note 28; Press Release, Federal Trade Commission, FTC Testifies on Enforcement, Consumer Education Initiatives to Combat Predatory Lending Practices (Feb. 26, 2001), at <http://www.ftc.gov/opa/2001/02/predlending.htm>.

127. Supervisory Guidance on Predatory Lending Practices, 6 Fed. Banking L. Rep. (CCH) ¶ 64-125, at 73,849-12 (Feb. 21, 2003) (discussing the HOEPA framework as an alternative means of curbing unfair and predatory lending practices).

128. See *infra* notes 192–213 and accompanying text.

129. Truth in Lending Act, Pub. L. No. 90-321, 82 Stat. 146 (codified at 15 U.S.C. § 1601 (2000)).

130. RALPH J. ROHNER & FRED H. MILLER, TRUTH IN LENDING 3 (2000).

order to “promote the informed use of consumer credit.”¹³¹ In its findings, it determined that “economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit.”¹³²

In 1994, Congress passed HOEPA as an amendment to the TILA in order to address specifically the predatory aspects of subprime mortgage loans.¹³³ Not all mortgage transactions, however, fit within the scope of HOEPA.¹³⁴ If the loan qualifies, HOEPA requires lenders to disclose more information than the initial TILA required,¹³⁵ and it places substantive limitations on the terms of the loan.¹³⁶

The loan must satisfy two basic requirements to garner HOEPA coverage. First, the statute only covers “consumer credit transaction[s] that [are] secured by the consumer’s principal dwelling.”¹³⁷ Moreover, it exempts mortgages that finance the acquisition or initial construction of a dwelling,¹³⁸ reverse mortgage transactions, and open-ended credit plans. “Thus, most covered transactions will be refinancing loans or home improvement loans and credit sales.”¹³⁹ HOEPA does cover both first and subordinate lien loans, as long as the loan is secured by the creditor’s residence.¹⁴⁰

Second, a loan must satisfy one of the two statistical tests before the borrower can enjoy HOEPA protection. A loan will satisfy the second element of HOEPA coverage if “[t]he annual percentage rate at consummation will exceed by more than 8 percentage points for first-lien loans, or by more than 10 percentage points for subordinate-lien loans, the yield on Treasury securities having comparable periods of maturity to the loan maturity.”¹⁴¹ The loan may also fulfill the second element if the

131. *Id.* at 4 (citing Regulation Z, 12 C.F.R. § 226.1 (2003)).

132. 15 U.S.C. § 1601(a) (2000).

133. See *Cooper v. First Gov’t Mortgage & Investors Corp.*, 238 F. Supp. 2d 50, 54 (D.D.C. 2002) (discussing the statutory history of HOEPA and TILA); see generally Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111 (2002). For a discussion of the predatory aspects of subprime mortgage loans see *supra* notes 2–3 and accompanying text.

134. 12 C.F.R. § 226.32 (2003) (outlining the elements of a HOEPA loan).

135. See *Cooper*, 238 F. Supp. 2d at 54.

136. 15 U.S.C. § 1602(aa); see *Cooper*, 238 F. Supp. 2d at 54 (“Congress intended HOEPA to result in greater disclosure to borrowers involved in high cost loans and to stop certain loan terms and practices.”); see also ROHNER & MILLER, *supra* note 130, at 452–57. Furthermore, lawyers may use a loan’s HOEPA status as a bargaining chip in settlement talks because qualification imprints the lender with the stigma of predatory lending.

137. 12 C.F.R. § 226.32(a)(1); ROHNER & MILLER, *supra* note 130, at 453. Some courts break this first requirement into four subparts. “More specifically, a high cost or HOEPA loan is: 1) a consumer credit transaction 2) with a creditor 3) that is secured by the consumer’s principal dwelling 4) and is a second or subordinate residential mortgage . . .” *Cooper*, 238 F. Supp. 2d at 53 (D.D.C. 2002); see also *Lopez v. Delta Funding Corp.*, No. CV 98-7204, 1998 WL 1537755, at *4 (E.D.N.Y. Dec. 23, 1998).

138. 12 C.F.R. § 226.2(24) (defining “residential mortgage transaction”); *id.* at § 226.32(a)(2)(i) (exempting “residential mortgage transactions”).

139. ROHNER & MILLER, *supra* note 130, at 453. As Williamson states, “[r]efinancing and home equity loans are covered.” Williamson, *supra* note 11, at 304.

140. 12 C.F.R. § 226.32(a).

141. *Id.* § 226.32(a)(1)(i).

total "points and fees"¹⁴² payable by the consumer at or before closing will exceed 8% of the total loan amount.¹⁴³ The amount an unsecured credit payoff should help satisfy this "points and fees" test.¹⁴⁴

If a loan satisfies both elements of the HOEPA statutory framework, it is then subject to restrictive rules for credit disclosure and to substantive limitations in the terms of the loan.¹⁴⁵ Along with the standard disclosure required by TILA,¹⁴⁶ HOEPA lenders must provide a warning notice about the transaction, the annual percentage rate, the amount of a regular monthly payment and the amount of a balloon payment, a statement that the interest rate and monthly rate might vary (in a variable-rate mortgage), and the amount borrowed.¹⁴⁷ The terms of a HOEPA-qualifying loan cannot include balloon payments,¹⁴⁸ negative amortization,¹⁴⁹ advance payments,¹⁵⁰ an increased interest rate after default,¹⁵¹ a refund calculated by the statutory actuarial method,¹⁵² prepayment penalties,¹⁵³ a due-on-demand clause,¹⁵⁴ or any other unfair or deceptive practices.¹⁵⁵

If a lender violates either the disclosure requirements or the substantive term limitations of HOEPA, the borrower can take advantage of "powerful" private remedies.¹⁵⁶ "HOEPA explicitly provided that violations of its special protection

142. For the description of which amounts qualify as a point or fee, see *infra* notes 160–73 and accompanying text. As defined by HUD, a point is "normally paid at closing and [is] generally calculated to be equivalent to 1% of the total loan amount . . . [Points] are paid to reduce the interest rate on a loan." HUD Housing Glossary, at <http://www.hud.gov/offices/hsg/sfh/buying/glossary.cfm> (last updated June 14, 2002) (last visited Jan. 15, 2005).

143. 12 C.F.R. § 226.32(a)(1)(ii). According to the statute, this "points and fees" amount must exceed at least \$400. *Id.* This \$400 minimum actually is "adjusted annually on January 1 by the annual percentage change in the Consumer Price Index that was reported on the preceding June 1." *Id.*; see also Williamson, *supra* note 11, at 303–04.

144. For a very thorough demonstration of the "points and fees" calculation, see Cooper v. First Gov't Mortgage & Investors Corp., 238 F. Supp. 2d 50, 58–61 (D.D.C. 2002).

145. 12 C.F.R. § 226.32(c)–(d); see also Avoiding Predatory and Abusive Lending Practices in Brokered and Purchased Loans, 6 Fed. Banking L. Rep. (CCH) ¶ 64-126, at 73,849–16 (Aug. 15, 2003) (discussing HOEPA along with other consumer protection statutes) [hereinafter Avoiding Predatory and Abusive Lending].

146. See ROHNER & MILLER, *supra* note 130, at 457 (describing the disclosures required for HOEPA loans as "special").

147. 12 C.F.R. § 226.32(c)(1)–(5).

148. *Id.* § 226.32(d)(1)(i). There is a narrow exception to the ban on balloon payments. See *id.* § 226.32(d)(1)(ii).

149. *Id.* § 226.32(d)(2).

150. *Id.* § 226.32(d)(3).

151. *Id.* § 226.32(d)(4).

152. *Id.* § 226.32(d)(5) (citing 15 U.S.C. § 1615(d) (2000)).

153. *Id.* § 226.32(d)(6). The statute lists exceptions to the ban on prepayment penalties. *Id.* § 226.32(d)(7).

154. *Id.* § 226.32(d)(8).

155. ROHNER & MILLER, *supra* note 130, at 466 ("The Board is authorized by HOEPA to prohibit other acts or practices in connection with covered loans that it finds to be unfair, deceptive, or designed to evade the special rules.") (citing 15 U.S.C. § 1639(i)(2)(A) (2000)).

156. Williamson, *supra* note 11, at 303–05.

provisions would entitle consumers to rescind mortgage loans and to recover the TILA statutory penalties."¹⁵⁷ The borrower's power of rescission lasts either for three years after the agreement or until she sells the property.¹⁵⁸ In addition, the borrower may recover the finance charges and fees connected to the extension of a loan that includes the improper terms.¹⁵⁹

Because of the remedies available under HOEPA, a borrower has a strong reason to fit his loan into the statutory framework. Thus, HOEPA can provide a remedial course currently lacking under the FTC Act. This Note argues that the amount of an unsecured credit payoff should count toward the satisfaction of the "points and fees" trigger test.

B. The Finance Charge as a Component in the HOEPA Points and Fees Test

As stated above, the second element for HOEPA coverage is satisfied if the "points and fees" payable by the borrower exceed 8% of the loan amount.¹⁶⁰ This requires a person to calculate two figures. He must first compute the threshold that satisfies the test (the 8% of the loan amount). He must then compare this figure to the points and fees he has been charged. In order to determine these points and fees, he must include the following four components:

- i) all items required to be disclosed under § 226.4(a) and § 226.4(b) [which includes finance charges], except interest or time-price differential; ii) all compensation paid to mortgage brokers; iii) all items listed in § 227.4(c)(7) . . . unless charge is reasonable . . . ; iv) premiums or other charges¹⁶¹

If the points and fees, including finance charges, reach the threshold, then the borrower's loan satisfies the second element.¹⁶²

The finance charges of a loan comprise a major component of the points and fees amount.¹⁶³ The total finance charge of a loan, simply put, "is the consumer's cost of

157. *Newton v. United Cos. Fin. Corp.*, 24 F. Supp. 2d 444, 451 (E.D. Pa. 1998) (citing 15 U.S.C. § 1639(j) (2000)).

158. 12 C.F.R. § 226.23(a)(3); *see also* ROHNER & MILLER, *supra* note 130, at 467 (discussing the remedies available under HOEPA).

159. 15 U.S.C. § 1640(a)(4) (2000); *see also* *Newton*, 24 F. Supp. 2d at 451; *Avoiding Predatory and Abusive Lending*, *supra* note 145, at 73,849–16; *Williamson*, *supra* note 11, at 304.

160. As 1 noted above, the total points and fees amount still must be over the minimum threshold that is adjusted each year (\$400 at the time HOEPA was passed). *See supra* note 143. For a clear description of finance charges in the TILA/HOEPA framework, *see* DEE PRIDGEN, *CONSUMER CREDIT AND THE LAW* § 6:2 (2003 ed.).

161. 12 C.F.R. § 226.32(b)(1); *see also* *Johnson v. The Know Fin. Group*, No. CIV.A.03-378, 2004 WL 1179335, at *5–7 (E.D. Pa. May 20, 2004) (calculating points and fees amount).

162. This description gives the gist of the HOEPA analysis. However, the actual calculation can be a bit more difficult. *See* ELIZABETH RENUART, NATIONAL CONSUMER LAW CENTER, *STOP PREDATORY LENDING: A GUIDE FOR LEGAL ADVOCATES* § 7.4.6, at 144–46 (2002) (discussing in great detail the steps needed to calculate the point and fees amount).

163. *See* 12 C.F.R. § 226.4 (describing which charges and fees in connection with a credit transaction are considered finance charges).

credit.”¹⁶⁴ The federal regulation interpreting TILA/HOEPA, Regulation Z, specifies which charges qualify as finance charges.¹⁶⁵ If an amount is considered a finance charge under the regulatory definition, the borrower nears the qualification threshold for HOEPA.¹⁶⁶ Because lenders often try to levy finance charges that near, but do not exceed, the 8% mark,¹⁶⁷ a small additional amount can lead to HOEPA classification.¹⁶⁸

As a practical matter, the regulation provides two avenues for a borrower to classify an amount as a finance charge. First, the amount may satisfy the four-part definition of a finance charge.¹⁶⁹ “The finance charge . . . includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or condition of the extension of credit.”¹⁷⁰ Second, the federal regulations may explicitly grant a particular type of charge finance charge status.¹⁷¹ Courts are more willing to consider an amount as a finance charge when it is listed in the regulation than when they have to apply the four-part definition.¹⁷² Still, courts have been willing to look outside the explicit examples.¹⁷³

C. Unsecured Credit Payoffs Fit the Regulatory Definition of a Finance Charge

Because the HOEPA regulations do not list unsecured credit payoffs as finance charges,¹⁷⁴ a borrower must instead satisfy the following four-part test:¹⁷⁵ a finance

164. ROHNER & MILLER, *supra* note 130, at 107.

165. 12 C.F.R. § 226; *see also* Household Credit Servs., Inc. v. Pfennig, 124 S. Ct. 1741 (2004) (upholding Regulation Z as a valid interpretive rule).

166. RENUART, *supra* note 162, at 145.

167. For instance, in *Johnson v. Banc One Acceptance Corp.*, 278 F. Supp. 2d 450, 459 n.8 (E.D. Pa. 2003), the lender argued that the “points and fees” amount totaled 7.9995% of the loan amount while the borrower argued that the amount totaled 8.0011%.

168. Judge Posner, in *Cowen v. Bank United of Texas, FSB*, 70 F.3d 937 (7th Cir. 1995), articulated the importance of finance charge arguments. “[A] suit for \$14 . . . may seem a quixotic project. Not so. . . [T]he plaintiffs, if they win, would be entitled to statutory damages of \$1000 without any proof of injury, because [TILA] allows the recovery of twice the finance charge up to \$1000, and the finance charge here exceeded \$500.” *Id.* at 941.

169. 12 C.F.R. § 226.4(a).

170. *Id.*

171. *Id.* § 226.4(b). Moreover, certain charges are explicitly excluded from finance charge status. *Id.* § 226.4(c).

172. *Cf.* JAMES H. PANNABECKER, 1 TRUTH-IN-LENDING MANUAL ¶ 2.01–.02 (rev. ed. 2003) (listing the outcomes of several cases decided both using the four-part test and using the explicit examples of a TILA finance charge).

173. *See, e.g.*, *First Acadiana Bank v. Fed. Deposit Ins. Corp.*, 833 F.2d 548, 549–50 (5th Cir. 1987) (holding that the attorneys’ fees charged were finance charges under Regulation Z’s standard definition); *Bumpus v. Vandeford*, No. 1:99CV070-SAA, 2002 U.S. Dist. LEXIS 20062, at *14–15 (N.D. Miss. Mar. 27, 2002) (finding that “weekly extension fees” satisfy the four-part test for finance charges); *see also* ROHNER & MILLER, *supra* note 130, at 114 (“Regulation Z lists a number of types of charges that are included, but makes clear that these are only examples and not an exhaustive list.”) (internal citation omitted).

174. 12 C.F.R. § 226.4(b).

175. *See supra* notes 160–72 and accompanying text.

charge is (i) any charge; (ii) payable directly or indirectly by the consumer; (iii) imposed directly or indirectly by the creditor; (iv) as an incident to or a condition of the extension of credit.¹⁷⁶ All mandatory third-party credit payoffs, including unsecured credit payoffs, meet this four-part definition of a finance charge.¹⁷⁷ The first element requires analysis while the three other elements are satisfied by the definition of a forced credit payoff.

First, an unsecured credit payoff is a charge. While the federal regulations do not define the term,¹⁷⁸ a “charge” is an expense faced by the borrower according to Black’s Law Dictionary.¹⁷⁹ The National Consumer Law Center’s *Truth in Lending Manual* states that “[u]sually, a charge will be in the form of a cost added on to the borrower’s obligation.”¹⁸⁰ An unsecured credit payoff meets these definitions, as it is an expense faced by the borrower in the credit transaction. The lender mandates the addition of the payoffs to the borrower’s obligation.

The District of Nebraska’s finding in *Campbell v. Liberty Financial Planning*¹⁸¹ supports the position that credit payoffs are “charges.” According to the court, when a lender requires a borrower to pay off debts owed to the lender, the amount of the payoff is a finance charge.¹⁸² While *Campbell* does not address third-party credit payoffs in the context of the “charge” analysis, the practice in *Campbell* is indistinguishable from third-party credit payoffs. Both unsecured credit payoffs and the practice in *Campbell* are credit payoffs; the fact that the money may go to an outside party does not make its status as a “charge” different from the practice in *Campbell*. Each results in an additional expense for the borrower.

The other three elements are easily satisfied.¹⁸³ The borrower pays the amount, satisfying the second element. Although the lender provides capital to the borrower, the borrower is still responsible for paying off the outside debt. The third requirement is fulfilled, as the creditor imposes the charge directly on the borrower. Finally, because the payoff is a condition of the extension of credit, the fourth requirement is satisfied. The borrower must agree to pay the amount before the lender will extend the credit.

While unsecured credit payoffs fit nicely into the four-part definition of a finance charge, no precedent exists to support or refute their inclusion in the definition—judges

176. This four-part formulation comes from the National Consumer Law Center. RENUART & KEEST, *supra* note 10, § 3.5, at 87. This formulation is useful in its simplicity and does not remove any important elements from the federal regulation. See 12 C.F.R. § 226.4(a).

177. The National Consumer Law Center’s *Truth in Lending* supports this conclusion. “[R]equired pay-offs literally meet all the definitional elements of the finance charge: they are a cost/charge, payable by the consumer, imposed by the creditor as a condition of the extension of credit.” RENUART & KEEST, *supra* note 10, § 3.6.1.1, at 88–89.

178. 12 C.F.R. § 226.4(a); RENUART & KEEST, *supra* note 10, § 3.6.1.1, at 88.

179. BLACK’S LAW DICTIONARY 227 (8th ed. 2004) (defining “charge” as a “[p]rice, cost, or expense”).

180. RENUART & KEEST, *supra* note 10, § 3.6.1.1, at 88.

181. 422 F. Supp. 1386 (D. Neb. 1976).

182. *Id.* at 1389.

183. See RENUART & KEEST, *supra* note 10, § 3.6.1.2, at 88.

have not analyzed this precise issue.¹⁸⁴ Furthermore, courts have split in their evaluations of practices similar to unsecured credit payoffs.¹⁸⁵ In a case in which a creditor forced a borrower to pay off loans owed to the creditor, a federal judge held a payoff amount to be a finance charge.¹⁸⁶ Importantly, this case provides an example of a court willing to classify as a finance charge an amount that is not listed in the federal regulation.¹⁸⁷ The court in *Smith v. Fidelity Consumer Discount Co.*,¹⁸⁸ however, determined that if a creditor forces a borrower to pay off a third-party lien on the collateral, the payoff amount does not count as a finance charge.

The practice in *Smith* can clearly be distinguished from unsecured credit payoffs. The creditor in *Smith* had an extremely high interest in guaranteeing that the collateral was free from outside liens before he entered into the credit contract.¹⁸⁹ Such a lien directly threatened the creditor's ability to recover upon default. The lender forcing unsecured credit payoffs, however, does not have a similar motivation when the third-party debts do not involve the collateral. If the borrower defaulted on the refinancing loan without paying off his unsecured outside debts, those outside unsecured creditors do not threaten the mortgage lender's claim on the collateral.¹⁹⁰

Because precedent does not provide courts considering whether to classify unsecured credit payoffs as finance charges with a clear approach (even though the practice satisfies the regulatory definition), policy arguments should influence the courts. The unremedied FTC Act-defined unfairness of unsecured credit payoffs should give courts a sufficiently strong policy incentive to classify the payoff as a HOEPA "finance charge," and thus provide an avenue to remedy the unfairness. Why should this unfairness provide an incentive to remedy the practice using HOEPA rather than a

184. In fact, very few courts have analyzed any type of credit payoff under TILA/HOEPA. See James D. Lockhart, Annotation, *What Constitutes "Finance Charge" Under § 106(a) of the Truth in Lending Act (15 U.S.C.A. § 1605(a)) or Applicable Regulations*, 154 A.L.R. FED. 431 (1999). Moreover, the Federal Reserve's Official Staff Commentary interpreting Regulation Z does not address whether unsecured credit payoffs count as a finance charge. See 12 C.F.R. pt. 226 (2004). Finally, the newest Supreme Court case addressing finance charges, *Household Credit Servs., Inc. v. Pfennig*, 124 S. Ct. 1741 (2004), provides no guidance. In *Pfennig*, a consumer argued that Regulation Z wrongfully excluded "over-limit fees" from finance charge classification. Hence, the plaintiff mounted a challenge against the text of the Regulation. *Id.* at 1744. Credit payoffs, on the other hand, are not explicitly listed in Regulation Z and are instead evaluated using the four-part test. See *supra* notes 174-77 and accompanying text. Thus, unlike *Pfennig*, this Note assumes that Regulation Z is a perfectly valid exercise in rule-making.

185. See generally RENUART & KEEST, *supra* note 10, § 3.6.1.2, at 89 (describing the different decisions involving credit payoffs); Lockhart, *supra* note 184, §§ 24-25 (same).

186. *Campbell*, 422 F. Supp. at 1389.

187. The court, finding the payoff amount to constitute a finance charge, stated: "The lack of clear precedent in this area notwithstanding, the Court is required by all of the above [statutory language] to find that the \$100 payment by plaintiff on his mother's account was an 'incident to the extension of credit' [and, therefore, a finance charge]." *Id.*

188. 898 F.2d 896, 906-07 (3d Cir. 1990).

189. After examining the federal regulations and the four-part test, the court stated: "Examining this list, we are left with the firm impression that prior liens are not within the definition of finance charge as that phrase was used by Congress." *Id.* at 906.

190. See LOPUCKI & WARREN, *supra* note 76, at 22.

different statutory framework? First, as demonstrated above, HOEPA can logically remedy the unfairness because HOEPA's definition of a finance charge encompasses unsecured credit payoffs. Second, two specific links between the statutes make HOEPA a suitable remedial choice. The FTC Act and HOEPA share public policy goals. Also, regulatory agencies have explicitly tied HOEPA and the FTC Act together in recent cases. In fact, the FTC has used a HOEPA violation as an incentive to find FTC Act unfairness.¹⁹¹ In light of this precedent, the use of FTC Act unfairness in the HOEPA scheme becomes a realistic strategy.

D. Justifying the Use of Incentives: The Theoretical Connection and Connection in Precedent Between HOEPA and the FTC Act

I. Policy Connection Between HOEPA and the FTC Act

Congress passed the FTC Act and HOEPA as two means of providing recourse to consumers facing the harsh world of unfettered markets.¹⁹² While the FTC Act generally aims at large-scale problems through agency action,¹⁹³ HOEPA provides private actors the ability to recover.¹⁹⁴ The two statutes, however, share a common goal—to curb abuses in subprime mortgage lending.¹⁹⁵

Several federal agencies demonstrate this common policy thread by using both laws as weapons against predatory lending techniques. The FTC testified to Congress about the usefulness of the two statutes in reducing abusive lending.¹⁹⁶ In an advisory letter, the OCC noted that HOEPA is not the only tool to fight predatory lending, but that “certain abusive lending can [also] involve unfair or deceptive practices and thus violate . . . the Federal Trade Commission Act.”¹⁹⁷ The OCC advises banks to comply

191. See *infra* notes 207–14 and accompanying text.

192. For the discussion of the increasing rate of foreclosures, especially in the subprime market, see *supra* note 2.

193. For instance, in *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354 (11th Cir. 1988), the FTC acted in response to the unfair treatment of around 200,000 customers. In *Fairbanks*, the FTC brought an “unfairness” action against one of the nation’s largest subprime lenders to curb persistent predatory lending. FTC, *Fairbanks Capital Settles*, *supra* note 59.

194. See *supra* notes 156–60 and accompanying text.

195. Clearly, the FTC Act has other goals besides curbing predatory lending. Reducing abuses in mortgage lending is one piece of the multi-prong act.

196. Press Release, Federal Trade Commission, *FTC Testifies on Enforcement and Education Initiatives to Combat Predatory Lending Practices; Asks Congress to Consider Legislative Expansions to Enhance Consumer Protection* (May 24, 2000), at <http://www.ftc.gov/opa/2000/05/subprime2.htm> (last visited Jan. 15, 2005).

197. Advisory Letter from the Office of the Comptroller of the Currency to Chief Executive Officers of All National Banks and National Bank Operating Subsidiaries, Department and Division Heads, and All Examining Personnel (Feb. 21, 2003), at <http://www.occ.treas.gov/ftp/advisory/2003-2.pdf> (last visited Jan. 15, 2005); see also Supervisory Guidance on Predatory Lending Practices Through Brokers or Other Intermediaries, 6 Fed. Banking L. Rep. (CCH) ¶ 64-126, at 73,849-16 (Aug. 15, 2003) (“High cost mortgage loans . . . must comply with the substantive protections and disclosure requirements set forth in the Home Ownership and Equity Protection Act Predatory loans may [also] involve violations of the Federal Trade Commission Act . . .”).

with both HOEPA and the FTC act in order to avoid predatory lending penalties.¹⁹⁸ Furthermore, Alan Greenspan, in a letter to Congress, explained the Federal Reserve's position that both statutes limit abuses in mortgage lending.¹⁹⁹ The two statutes clearly aim to alleviate the same problem.

The shared policy goals of the two statutes demonstrate a close connection that justifies the statutory crossover that this Note suggests. Because the two statutes share a common aim, a judge will not overstep the policy boundaries of HOEPA when she uses it to remedy unfairness by classifying unsecured credit payoffs as finance charges.²⁰⁰

2. Connection in Precedent Between HOEPA and FTC Act

Recent FTC enforcement actions illustrate a connection in precedent between the two statutes sufficient to justify the use of FTC Act unfairness as an incentive to employ HOEPA. An FTC action against Barry Cooper Properties, a subprime mortgage lender, displays the clearest example of this link.²⁰¹ In *Barry Cooper*, the lender allegedly included a prepayment penalty prohibited by HOEPA.²⁰² The FTC, recognizing in its complaint the connection between HOEPA and the FTC Act, stated that the HOEPA violation contributed to the unfairness of the alleged prepayment penalties. "By engaging in a pattern or practice of making HOEPA mortgage loans without regard to the payment ability of the consumers . . . the defendant has engaged, and continues to engage, in unfair acts or practices in violation of Section 5 (a) of the FTC Act, 15 U.S.C. § 45(a)."²⁰³ In its final order, the agency found that this HOEPA

198. The OCC also discussed the Real Estate Settlement Procedures Act ("RESPA") and Equal Credit Opportunity Act ("ECOA") as other statutes that attempt to curb predatory lending practices. The agency suggests that banks and other lending agencies need to consider each of these statutes when attempting to avoid predatory lending practices. Supervisory Guidance on Predatory Lending Practices Through Brokers or Other Intermediaries, 6 Fed. Banking L. Rep. (CCH) ¶ 64-126, at 73,849-16, 17 (Aug. 15, 2003); see also Press Release, OCC, OCC Chief Counsel Julie L. Williams Urges Banks to be Vigilant in Avoiding Unfair and Deceptive Marketing Practices (Mar. 22, 2002), at www.occ.treas.gov/2002/march.htm (last visited Jan. 15, 2005).

199. Letter from Alan Greenspan to John J. LaFalce, *supra* note 28 (discussing the Federal Reserve's role in limiting predatory lending).

200. It is important to reiterate that this Note does not suggest that all "unfair" practices should qualify as finance charges.

201. See generally Consent Judgment and Order for Permanent Injunction, *FTC v. Barry Cooper*, FTC No. 982-3200 (C.D. Cal. 1999), <http://www.ftc.gov/os/1999/07/bcconddec.htm> (last visited Jan. 15, 2005).

202. *Id.* at 3; Press Release, Federal Trade Commission, Home Equity Lenders Settle Charges that They Engaged in Abusive Lending Practices; Over Half Million Dollars To Be Returned to Consumers (July 29, 1999), at <http://www.ftc.gov/opa/1999/07/hoeпа.htm> (last visited Jan. 15, 2005). [hereinafter *FTC, Home Equity Lenders*].

203. Complaint for Permanent Injunction and Other Equitable Relief, *FTC v. Barry Cooper*, FTC No. 982-3200 (C.D. Cal. 1999), <http://www.ftc.gov/os/1999/07/hoeпаbarrycoopercmp.htm>.

violation provided the FTC with an incentive to find an "unfair" trade practice.²⁰⁴ Only one of the five commissioners disagreed with this approach.²⁰⁵

The FTC has not limited this argumentative technique to *Barry Cooper*. In fact, it has used a HOEPA violation as an incentive to find FTC unfairness in four other enforcement actions.²⁰⁶ As Commissioner Orson Swindle noted in his dissent, "[t]hese unfairness allegations are based on the theory that although these actions, standing alone without HOEPA, do not meet the test for unfairness, factoring in HOEPA as evidence of 'established public polic[y]' tips the balance toward establishing unfairness."²⁰⁷ These cases illustrate the strong bond in precedent between the two statutes.²⁰⁸

Not only do these cases amplify the public policy connection between HOEPA and the FTC Act, illustrated above,²⁰⁹ but they also demonstrate a practical connection that the regulatory hodies use frequently. Moreover, the cases legitimate the argument that this Note employs to classify payoffs as finance charges. The agency actions have validated the use of a statutory violation as an incentive to employ a second, closely-related statute. The FTC, in fact, uses the same two statutes that this Note uses. *Barry Cooper* provides clear support for the argument presented.

Moreover, the FTC's HOEPA-FTC Act argument in *Barry Cooper* provides vital precedent to a court considering whether to classify unsecured credit payoffs under HOEPA. As stated above, unsecured credit payoffs fit into the statutory definition of a HOEPA finance charge, yet no precedent existed to support such a classification.²¹⁰ After *Barry Cooper*, courts can rely on established case law to classify the payoffs as finance charges. The FTC in *Barry Cooper* demonstrated that it is justifiable to use a statutory violation as an incentive to employ a connected statute. A judge who employs HOEPA after considering the FTC Act will not act in an unprecedented way.

One may argue *Barry Cooper* does not apply to my HOEPA-FTC Act argument because the case only discusses the use of a HOEPA violation as an incentive to find FTC Act unfairness. *Barry Cooper* does not suggest that a court can use unfairness to

204. See FTC, Home Equity Lenders, *supra* note 202. Commissioner Orson Swindle explicitly stated, in dissent, that the FTC was using the HOEPA violation as an incentive.

205. As stated above, Commissioner Orson Swindle did not agree that HOEPA violations should be used as an incentive to find FTC unfairness. *Id.*

206. FTC v. Granite Mortgage, LLC, FTC No. 982-3167 (E.D. Ky. 1999); FTC v. LAP Fin. Servs., Inc., FTC No. 982-3169 (W.D. Ky. 1999); CLS Fin. Servs., FTC 982-3171 (W.D. Wash. 1999); FTC v. Wasatch Credit Corp., FTC No. 982-3191 (D. Utah 1991).

207. Statement of Commissioner Orson Swindle Concurring in Part and Dissenting in Part to *In re Granite Mortgage, LLC*, File No. 982-3167; LAP Financial Servs., Inc., File No. 982-3169; CLS Mortgage Inc., File No. 982-3171; Wasatch Credit Corp., File No. 982-3191, all available at <http://www.ftc.gov/os/1999/07/swindlestategranite.htm> (July 1999) (second alteration in original) (citation omitted) (last visited Jan. 15, 2005).

208. Several additional agency enforcement actions further illustrate this doctrinal connection between the two statutes. Recently, the OCC determined that Clear Lake National Bank charged fees in the mortgage lending context that violated both HOEPA and the FTC Act. *In re Clear Lake National Bank*, #AA-EC-03-25 (U.S. Dept. of Treasury, OCC 2003), available at <http://www.occ.treas.gov/ftp/eas/ea2003-135.pdf> (last visited Jan. 15, 2005).

209. See *supra* notes 192-200.

210. See *supra* note 184 and accompanying text.

employ HOEPA; nothing in the case supports linking the statutes in the other direction.²¹¹

Three arguments counter this suggestion. First, the shared policy goals of the two statutes facilitate the use of incentives in both directions. Second, *Barry Cooper*, and the later cases, did not discuss the use of the FTC Act violation as an incentive because the HOEPA violation was clear in those cases.²¹² The HOEPA arguments needed no boost. Finally, this Note's use of an incentives argument requires less of a stretch in statutory definitions than the use in *Barry Cooper*. While in *Barry Cooper* the HOEPA violation covered for a deficiency in the unfairness argument, no such deficiency exists in my HOEPA argument. Unsecured credit payoffs fit into the four-part statutory definition of a finance charge.²¹³ The use of the FTC Act violation provides a supplemental policy incentive; even without this policy claim, a court could fit unsecured credit payoffs into HOEPA.

CONCLUSION

Due to the theoretical connection and the connection in precedent between the FTC Act and HOEPA, courts can employ the HOEPA framework as an avenue to remedy the unfairness present in unsecured credit payoffs. Classifying the sum as a finance charge will significantly increase the chance that the borrower will enjoy HOEPA's substantive protections. Importantly, remedying this credit practice within the HOEPA framework does not stretch the boundaries of the statute at all—the practice fits neatly in the definition of a finance charge. By applying the HOEPA framework to unsecured credit payoffs, courts can provide relief to borrowers facing unremedied FTC Act unfairness.

211. See *supra* notes 201–05 and accompanying text.

212. Prepayment penalties are explicitly prohibited in HOEPA-qualifying loans. 12 C.F.R. § 226.32(d)(6) (2003).

213. See *supra* notes 174–91 and accompanying text.