No. 02-634

IN THE
SUPREME COURT OF THE UNITED STATES

GREEN TREE FINANCIAL CORP. a/k/a/ GREEN TREE ACCEPTANCE CORP. a/k/a GREEN TREE /FINANCIAL SERVICES CORP. n/k/a CONSECO FINANCE CORP.

Petitioner,

v.

LYNN W. BAZZLE AND BURT A. BAZZLE, In a Representative Capacity On Behalf Of A Class And For All Others Similarly Situated; DANIEL B. LACKEY, GEORGE BUGGS AND FLORINE BUGGS, In A Representative Capacity On Behalf Of A Class And For All Others Similarly Situated,

Respondents.

On Writ of Certiorari To The Supreme Court of South Carolina

BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF RESPONDENTS

STACY J. CANAN*
DEBORAH M. ZUCKERMAN
NINA SIMON
JEAN CONSTANTINE-DAVIS
AARP FOUNDATION

601 E Street, N.W.
Washington, DC 20049
(202) 434-2060

*Counsel of Record

MICHAEL R. SCHUSTER
AARP

Counsel for *Amicus Curiae*
AARP

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Lynn W. Bazzle and Burt A. Bazzle, et al.

Respondents.

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BRIEF *AMICUS CURIAE* OF AARP IN SUPPORT OF RESPONDENTS

INTEREST OF *AMICUS CURIAE*[1]

AARP is a non-profit organization with more than thirty-five million members dedicated to addressing the needs and interests of people age fifty and older. As the largest membership organization serving older Americans, AARP is greatly concerned about the rampant deception, fraud, and

[1] The parties' consents have been filed with the Clerk of the Court. In compliance with Rule 37.6 of this Court, *amicus curiae* AARP state that no counsel for any party authored this brief in whole or in part and that no party or entity other than the *amicus curiae*, their members or counsel made a monetary contribution to the preparation or submission of this brief.

unfair practices perpetrated in a broad range of consumer transactions. Older Americans are disproportionately victimized by such practices. AARP thus supports laws and public policies designed to protect their rights and to preserve the legal means for them to seek redress when they are harmed in the marketplace.

AARP, for over a decade, has been concerned about the problem of predatory mortgage lending, which disproportionately targets and adversely impacts elderly and minority borrowers and threatens to undo years of progress in community development across the country. Nearly 80 percent of older Americans are homeowners, and a majority of these older homeowners own their own homes free and clear or have at least $50,000 saved in home equity. Considering the high rate of home ownership and accrued equity among older Americans, the magnitude of predatory lending, and its impact upon older Americans, is enormous. AARP, therefore, has made predatory lending a priority by educating its members, researching issues, litigating cases, and advocating in federal and state regulatory and legislative bodies for laws that protect and provide redress to consumers and deter abusive practices.

AARP is also concerned that concurrent with the rise of predatory lending practices is the pervasive insertion of mandatory and binding arbitration clauses into consumer adhesion contracts. Many lenders and finance companies that are engaging in deceptive and unfair lending practices are also attempting to use mandatory pre-dispute arbitration as a shield from liability. AARP is filing this brief because of grave concern that reversal of the decision below will impede private enforcement of important state laws enacted to protect vulnerable consumers thereby allowing violators of these laws to evade liability.

SUMMARY OF ARGUMENT

The types of lending practices in which Green Tree engaged in this case are typical of the types of deceptive lending practices that have become a burgeoning and devastating problem in recent years. These abusive lending practices are commonly referred to as "predatory" because the loans are usually sold through aggressive and deceptive sales and marketing. Although predatory lending practices are varied, the most commonly reported forms of abuse are:

1. Providing borrowers with misleading information, manipulating borrowers through aggressive sales tactics, and taking advantage of borrowers' lack of sophistication.

2. Making loans that borrowers cannot afford to repay leading to foreclosure or bankruptcy.

3. Targeting minority, female, elderly and low-income borrowers.

4. Refinancing loans repeatedly over a short period of time through a process known as "flipping," rolling new costs and fees into the loan at each refinancing without benefit to the borrowers.

5. Charging borrowers unnecessary and exorbitant interest rates and fees in loans, including hidden pre-payment penalties, large balloon payments, yield spread premiums, and expensive lump-sum credit insurance premiums.

6. Providing subprime loans with interest rates higher than borrowers should have received.

Once a homeowner's credit has been damaged by the inability to repay high-cost debt, predatory subprime lenders are the only ones willing to make credit available, often on extortionate terms.

Moreover, subprime loans are disproportionately made to elderly and minority borrowers. Indeed, the explosion of subprime lending has replaced prime lending opportunities for many older and minority borrowers, even for those who could qualify for prime loans.

The subprime lending boom has had an adverse impact upon the individuals receiving the loans, their families and the neighborhoods in which they live. Not only have foreclosure rates soared in recent years, but studies show that predatory lending practices undermine entire neighborhoods. Equity-stripping and foreclosures cause neighborhood instability, depressed property values and increased crime. Abandonment of foreclosed housing also causes local tax revenues to fall, which erodes the funding base for public services.

The explosive growth of predatory lending has occurred largely without any corresponding increase in federal laws and regulatory resources designed to halt the problem. As a result, existing federal laws and regulators are not adequately protecting consumers or preventing the growth of predatory lending abuses. Many states, therefore, have necessarily responded to the emergence of predatory lending practices by enacting additional consumer protection legislation aimed at deterring abusive and deceptive high-cost, non-purchase (refinance) home loans. The laws are a measured and permissible response to a public emergency and are enacted pursuant to the states' police powers. State legislatures allow consumers to enforce these laws as private attorneys general to further the laws' remedial purposes to protect consumers and deter deceptive and abusive trade practices.

Concurrent with the growth of predatory lending is the pervasive use of mandatory binding arbitration clauses in consumer adhesion finance contracts. Petitioners and their *amici* advocate allowing creditors to impose an arbitration system that thwarts consumers' ability to vindicate their rights under state consumer protection laws by barring class actions. The class action remedy is an essential component to enforcing many state consumer protection laws and is a powerful deterrent to wrongful conduct. Indeed, class actions remain the only realistic way for consumers with small monetary claims to vindicate their rights under, and to promote compliance with, laws enacted to protect the public. Without class relief, state consumer protection laws' deterrent and remedial functions would be reduced to nothing more than a mere nuisance to creditors. If consumers are forced into the arbitral forum without the right to seek class-wide relief, creditors will be able to avoid statutory compliance with impunity.

ARGUMENT

I. CONSUMERS NEED PROTECTION DUE TO THE EXPLOSIVE GROWTH OF SUBPRIME LENDING AND THE PREDATORY LENDING PRACTICES EMPLOYED BY SOME SUBPRIME LENDERS

The types of lending practices in which Green Tree engaged in this case are typical of the types of deceptive lending practices that have become a burgeoning and devastating nationwide problem in recent years. These abusive lending practices are commonly referred to as "predatory" because the loans are usually sold through aggressive and deceptive marketing and sales tactics. Kellie K. Kim-Sung & Sharon Hermanson, AARP Pub. Policy Inst., *Experiences of Older Refinance Mortgage Loan Borrowers: Broker- and Lender-Originated Loans* 1 (January 2003) [hereinafter *"Experiences of Older Borrowers"*], *available at* http://research.aarp.org/consume/d83_loans.html. In the instant cases,[2] Green Tree employed "the most pernicious form of solicitation, ... door-to-door salespeople [coming] in the form of home-improvement contractors who [are] working as brokers for mortgage companies." These salespeople "convince elderly homeowners that particular repairs are necessary and that easy financing can be arranged without disclosing the true cost of the loan." *See* Odette Williamson, *Protecting Elderly Homeowners from Predatory Mortgage Lenders*, J. Poverty L.& Pol'y 297 (Sept.-Oct. 2000) [hereinafter "*Protecting Elderly Homeowners*"].

The growth of predatory lending practices coincides with the explosive growth of subprime lending, although not all subprime loans are predatory. Subprime loans are loans made

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[2] In *Bazzle*, Green Tree violated South Carolina Consumer Protection Code when selling mortgage loans to homeowners paying for home improvement work after being solicited by door-to-door salespeople. Similarly in *Lackey*, Green Tree violated South Carolina Consumer Code when providing financing for manufactured home sales. *Bazzle v. Green Tree Financial Corp*., 351 S.C. 244, 249-50, 254; 569 S.E.2d 349, 352-3, 354 (2002).

at higher interest rates than the prime market rate.[3/] Recent studies have shown that the national rate of subprime lending has skyrocketed from the early 1990s. From 1993 to 1998, the number of subprime loans in the United States increased ten-fold, from 80,000 to 790,000. HUD, *Unequal Burden in New York: Income and Racial Disparities in Subprime Lending* 2 (2000) [hereinafter "*Unequal Burden in NY*], *available at* http://www.hud.gov/library/bookshelf18/pressrel/subprny.html. The Federal Reserve Board observes that "the number of subprime loans made by lenders that identify themselves primarily as subprime lenders increased about six times -- from 138,000 in 1994 to roughly 856,000 in 1999." *See* Fed. Reserve Sys. Proposed Rule, 65 Fed. Reg. 81438, 81439 (2000). In the metropolitan Chicago area, subprime loans increased from 3,137 in 1991 to almost 51,000 in 1997, a 1,524 percent increase. George Goehl & Gordon Mayer, *Preying on Neighborhoods, Subprime Lending and Chicagoland Foreclosures* 4 (Sept. 21, 1999) [hereinafter "*Preying on Neighborhoods"*], *available at* http:www.ntic.us.org/preying/preying.html. With the dramatic increase in loan originations, the dollar volume of subprime loans also soared from $35 billion in 1994 to $160 billion in 1999. *See*, HUD, *Unequal Burden: Income and Racial Disparities in Subprime Lending in America* (May 2000) [hereinafter "*Unequal Burden in America*"], *available at* http://frwebgate.access.gpo.gov/cgi-bin

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[3/] In addition to subprime mortgage lending, other high interest rate loan markets have grown substantially since the early 1990's, including high-rate auto loans with interest rates ranging from 15 to 25 percent, credit cards with interest rates ranging from 20 to 40 percent, payday loans that carry annual percentage rates of 300 percent or more, and rent-to-own transactions with implicit interest rates over 100 percent. Hogarth & Hilgert, *A Profile of Consumers With High Rate Home Loans*, Fin. Counseling and Planning, Vol. 13(1)15 (2002) [hereinafter *Hogarth & Hilgert*; *see also*, George Gaberlavage & Sharon Hermanson, AARP Pub. Policy Inst., *The Alternative Financial Services Industry,* (2001), available at http://research.aarp.org/consume/dib51_finance.pdf; Jean Ann Fox, Consumer Fed'n of Am., *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry* (1998); Jean Ann Fox, Consumer Fed'n of Am., *Safe Harbor for Usury: Recent Developments in Payday Lending* (1999), *vailable at* www.consumerfed.org.

/getdoc.cgi?dbname=2000_register&docid=00-17520-filed.

Although predatory lending practices are varied, the most commonly reported abuses[4/] are:

1. Providing borrowers with misleading information, manipulating borrowers through aggressive sales tactics and taking advantage of borrowers' lack of sophistication. *See* U.S. Dep't of Treasury ("Treasury") & U.S. Dep't of Housing and Urban Development ("HUD"), *Curbing Predatory Home Mortgage Lending: A Joint Report* 17 (2000), [hereinafter *"Treas. & HUD Joint Report"*], *available at* http://www.huduser.org/ publications/hsgfin/curbing.html.

2. Making loans that borrowers cannot afford to repay leading to foreclosure or bankruptcy. *Id.*

3. Targeting minority, female, elderly and low-income borrowers. *Id*. at 72.

4. Refinancing loans repeatedly over a short period of time through a process known as "flipping," in which new costs and fees are rolled into the loan at each refinancing with no benefit to the borrowers. Flipping leads to depletion of home equity. *Id.* at 73-74.

5. Charging borrowers unnecessary and exorbitant interest rates and fees in loans, deceptively including hidden pre-payment penalties, large balloon payments, yield spread

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[4/] *See also Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices*, (OCC Advisory Letter 2003-2), *available at* http://www.occ.treas.gov/ftp/advisory/2003%2D3.pdf, for the OCC's description of predatory mortgage lending abuses.

premiums,[5/] and expensive lump-sum credit insurance premiums. *Id.* at 79-80, 88-92, 96.

6. Providing borrowers with good credit ratings subprime loans with interest rates higher than they should have received. A recent study found that borrowers with good credit ratings were sold loans with interest rates averaging 17.56 percent, while the industry average for such borrowers was 9 percent. *See* National Training And Information Center ("NTIC"), *Slash and Burn Financing: A Study of CitiFinancial's Recent Lending in Chicago* 8-9 (Dec. 17, 2001), *available at* http:\\www.ntic-us.org/currentevents/press/pdf/Slash%20and%20Burn.pdf.

Predatory and deceptive lending practices are especially rampant in the manufactured home loan market. For example, among other things, purchasers are sold (1) loans they cannot afford, (2) homes worth substantially less than the purchase price, (3) loans packed with insurance, financed "points" and other charges that leave the purchasers with negative equity for the first several years after their purchase. Consumers Union, *In Over Our Heads: Predatory Lending and Fraud in Manufactured Housing* (February 2002), *available at* http://www.consumersunion.org/other/mh/overinfo.htm.

The above-described abuses create a disastrous cycle for many homeowners. Once a homeowner's credit has been damaged by the inability to repay high-cost debt, predatory lenders are the only ones willing to make credit available, often on extortionate terms. *See* Woodstock Institute, *Two Steps Back: The Dual Mortgage Market, Predatory Lending and the*

[5/] A "yield-spread premium" is defined as an arrangement "whereby the creditor charges a higher rate than it would otherwise impose on a loan, and gives the difference, or some portion of it, to a referring broker." National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* §4.7.2 (2nd ed. 2000 & Supp. 2002). *See also, Culpepper v. Inland Mortgage Corp.,* 132 F.3d 692, 694 (11th Cir. 1998); and *Culpepper v. Irwin Mortgage Corp.,* 253 F.3d 1324 (11th Cir. 2001) (*"Culpepper II")*.

Undoing of Community Development 2 (1999) [hereinafter "*Woodstock Inst. Study*"], *available at* http://www.woodstockinst.org/2steps.pdf.

A. Studies Show That Most Subprime Lenders Target Older and Minority Homeowners

The explosion of subprime lending has replaced prime lending opportunities for many older and minority borrowers, even those who could qualify for prime loans. *See* George Gaberlavage & Sharon Hermanson, *The Alternative Financial Services Industry*, AARP Pub. Policy Inst. 6-7 (2001) [hereinafter "*Alternative Financial Services*"], *available at* http://research.aarp.org/consume/ib51_finance.html (noting that between 10 percent and 35 percent of borrowers receiving high cost loans actually qualified for prime loans).

1. Older Homeowners Receive a Disproportionate Share of Subprime Loans

Predatory lenders often target older homeowners because they are likely to have built up significant equity in their homes, may live on fixed incomes and need cash for medical expenses or home repairs, and may be vulnerable to aggressive sales tactics *See Treas. & HUD Joint Report*, *supra*, at 69-70; *see also Protecting Elderly Homeowners, supra,* at 297. Thirty-five percent of subprime borrowers are age fifty-five or older, according to a report by the Federal Home Loan Mortgage Corp.,[6] commonly referred to as Freddie Mac, cited in HUD's report *Unequal Burden in NY, supra,* at 4. Borrowers age sixty-five or older are three times more likely to hold a subprime loan than borrowers who are thirty-five or younger. *Id.* at 17. Borrowers over forty-five are almost six times more likely to have a subprime loan than thirty-five-and-under borrowers. Neal Walters & Sharon Hermanson, *Subprime Mortgage Lending and Older Borrowers*, AARP Pub. Policy Inst., Digest 57,2 (Mar.2001), [hereinafter "*Older*

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[6] Howard Lax, et al., *Subprime Lending: An Investigation of Economic Inefficiency* 9 (Feb. 25, 2000) (unpublished report, on file with AARP).

Subprime Borrowers"], *available at* http://research.aarp.org/consume/dd57_lending.html. The AARP study also found that older subprime borrowers are more likely to have had a decrease in income or a serious illness than older prime borrowers, and more likely to be financially inexperienced and unfamiliar with basic loan terminology. *Id.* at 4. This combination of factors makes older borrowers particularly vulnerable. *See also* Sharon Hermanson, AARP Pub. Policy Inst. *Older Subprime Refinance Mortgage Borrowers* 3 (July 2002) (noting that 54 percent of older subprime borrowers reported taking the loan as a result of an ad or sales call that guarantee approval. Far fewer prime borrowers selected their loan company on the basis of such an offer); *Woodstock Inst. Study*, *supra,* at 8.

2. Racial Minorities And Women Receive a Disproportionate Share of Subprime Loans

Subprime lenders also target sales to minority neighborhoods. According to HUD, minority neighborhoods around the nation are under-served in the refinancing market by prime lenders and disproportionately reliant on subprime lenders thereby creating a classic "dual market," with prime lenders and subprime lenders serving different populations. *See Unequal Burden in America, supra,* at 1-2. In New York in 1998, for example, subprime lending accounted for 60 percent of home refinancing in predominately African American neighborhoods, compared with only 13 percent in predominately white neighborhoods. *See Unequal Burden in NY, supra,* at 3. Woodstock Institute's 1999 study confirms HUD's finding that African American neighborhoods and individuals are more likely to be targeted for subprime loans than their white counterparts. *See Woodstock Inst. Study, supra,* at 29.

This trend continues today, as evidenced in a 2002 study finding that minorities nationwide continue to be much more likely to have subprime loans compared to whites. Center for Community Change, *Risk or Race? Racial Disparities and the Subprime Refinance Market* (May 2002), *available at* http://www.communitychange.org/NRP/riskorrace.asp. The report notes that, while white borrowers had 17.42 percent of conventional refinance loans, black borrowers had 49.28 percent, Hispanic borrowers had 30.33 percent, and Native Americans had 27.94 percent. *Id.* at 3. Even when accounting for income, upper-income black borrowers "have a higher percentage of subprime loans than do lower-income whites." *Id*. at 8. Moreover, these disparities exist in all regions of the United States, regardless of the size of the urban area. *Id*. at 9, 24-5.

Women also receive a disproportionate number of subprime loans. Women receive a larger percentage of subprime loans compared to men, with Black women receiving the highest share. For example, in Texas in 2000, Black women received subprime loans two and half times more than white men. Consumers Union, *Women in the Subprime Market* (2002), *available at* http://www.consumersunion.org/finance/women-rpt1002.htm.

B. The Aftermath of Predatory Lending Harms Homeowners and Destroys Neighborhoods

1. Predatory Lending Has Led to Increased Residential Foreclosure Rates

U.S. borrowers annually lose $9.1 billion to predatory lending practices. Eric Stein, A Report from the Coalition for Responsible Lending, *Quantifying the Economic Cost of Predatory Lending* 2 (July 25, 2001, revised October 30, 2001), *available at* http://www.responsiblelending.org/research/quantify.cfm. These astronomical losses are caused through excessive foreclosures and lenders stripping equity and charging borrowers higher interest rates than their credit histories would indicate is justified. *Id.* Residential foreclosure rates have dramatically increased largely due to subprime lenders use of "asset-based lending," where a loan is approved based on the homeowner's equity in the secured property, rather than on a borrower's ability to repay the loan. This practice is among the most prevalent and harmful of predatory lending practices. *Report to Board of Governors of the Federal Reserve System on Predatory Lending Practices in the Home-Equity Lending Market* (September 7, 2000) (Statement of Peggy Twohig, Asst. Dir. for Fin. Prac. for the Federal Trade

Commission) [hereinafter "*FTC Report to Fed. Reserve* Sys."],

available at http://www.ftc.gov/os/2000/09/predatory lending.htm.

It is no surprise, therefore, that as subprime lending has increased, so have foreclosure rates. For example, the number of foreclosures of high cost mortgages increased nearly 500 percent from 1993-2001. NTIC, *Outside the Law: How Lenders Dodge Community Reinvestment* 8, 12 (March 2003) [hereinafter *"Outside the Law"*], *available at* http://www.ntic-us.org/currentevents/press/pdf/Outside%20the%20Law.pdf. Another study found that foreclosures on high interest rate loans increased more than 400 percent in Chicago from 1993 to 1998. *Preying on Neighborhoods, supra,* at 4, 6 & 20; *Treas. & HUD Joint Report*, *supra,* at 49-51. Similarly, in Back of the Yards, another Chicago neighborhood, there were 247 foreclosures in a twelve by seventeen block area, representing 11 percent of the 2,338 total structures in the neighborhood. *See* Bruce Gottschall, *The View from the Back of the Yards: Summary of Preliminary Analysis of Foreclosure Data* 1 (Nov. 2000). The neighborhood experienced one foreclosure for every three new mortgages. *Id.* Of these foreclosures, at least 75 percent were attributable to known predatory lenders, the vast majority of them based outside of Illinois and having no depository relationship to the neighborhood.

South Carolina has likewise seen a surge in residential foreclosures stemming from subprime loans. A recent survey conducted by the Mortgage Bankers Association of America revealed that foreclosure rates in South Carolina are breaking prior records. Significantly, the survey found that new foreclosures were started on subprime loans seven to nine times as often as on conventional prime mortgages in the third quarter of 2002. Mortgage Bankers Ass'n, *National Delinquency Survey for 3rd Quarter 2002* (Jan. 3, 2003).

The increase of foreclosures has also been reported in the manufactured housing market, which has seen a "rash of foreclosures . . . and substantially higher default rates among subprime borrowers." The Joint Center for Housing Studies of Harvard University ("Joint Center"), *The State of the Nation's*

Housing 18 (2002). The Joint Center noted that the rise in foreclosures among manufactured housing purchasers is evidence that the recent gains in home ownership among lower-income families may not prove durable. *Id.*

The foreclosure data described above demonstrates the dire economic consequences predatory loans have for individual borrowers and their families. Homeowners lose both their homes and the equity they have built up over the years, usually the only significant asset they have. Even if borrowers manage to keep up with loan payments, the loans strip them of their accrued equity and reduce their household budget for other essential needs. Homeowners are often left with substantial debt that they cannot afford. *See Woodstock Inst. Study, supra,* at 1.

2. Predatory Lending Is Destroying Neighborhoods

The impact of predatory lending extends beyond those individuals and families who have been victimized. Studies show that entire neighborhoods are harmed by predatory lending practices. Equity-stripping and foreclosures take cash out of neighborhoods, shake the confidence of other homeowners, which in turn causes rapid decline of a neighborhood. Foreclosed homes frequently remain vacant for a prolonged period of time leading to neighborhood instability, depressed property values and increased crime. *See Treas. & HUD Joint Report, supra,* at 25. Abandonment of housing also causes local tax revenues to fall, which erodes the funding base for public services. *Protecting Elderly Homeowners, supra,* at 309. *See also, Woodstock Inst. Study, supra,* at 8 (finding that "[p]redatory lending has reached a scale where it has now been recognized as a major community development problem . . .[and][i]t threatens decades of effort in promoting homeownership as a means of wealth creation and neighborhood stabilization."). *See also* James H. Carr & Jenny Schuetz, Fannie Mae Foundation, *Financial Services in Distressed Communities: Issues and Answers* (Aug. 2001), *available at* http://www.fanniemaefoundation.org/programs/financial.PDF.

II. FEDERAL LAWS AND REGULATORS ARE NOT ADEQUATELY PROTECTING CONSUMERS FROM THE HARMFUL EFFECTS OF PREDATORY LENDING AND PREVENTING THE BURGEONING GROWTH OF PREDATORY LENDING

The deregulation of the consumer lending industry in the 1980s has lead the way for the nationwide explosive growth of predatory lending. *Protecting Elderly Homeowners*, *supra,* at 297. Regulatory oversight has not kept pace with the recent changes in the mortgage lending industry. *Experiences of Older Borrowers, supra,* at 1. For example, because many subprime lenders are not depository institutions, they are subject to less regulation than most prime lenders.[7/] Therefore, subprime lenders have more leeway to engage in unscrupulous lending practices, absent strong state regulations to constrain them. *See* HUD, *Unequal Burden in Chicago: Income and Racial Disparities in Subprime Lending* 2 (May 2000). Additionally, the majority of subprime loans are not subject to federal Community Reinvestment Act (CRA) requirements. 12 U.S.C.A. § 2901 (2003). *Experiences of Older Borrowers*, *supra,* at 1; *Outside the Law, supra,* at 2-3 (finding that fifteen out of the top twenty-five lenders (60 percent) in the U.S. are not strictly regulated by the CRA, and seventeen out of the top twenty-five lenders (68 percent) in low to moderate income census tracts are not strictly regulated by the CRA).

[7/] "In the U.S., there are effectively several tiers of financial institutions. The mainstream financial institutions include commercial banks, thrifts and savings banks, and credit unions. These institutions are regulated by state and federal authorities and are subject to regular examinations for safety and soundness and compliance with regulations. A secondary tier includes institutions such as finance and loan companies and vehicle finance companies. These institutions are generally not subject to federal examinations, although they are required to comply with state and federal regulations. These second-tier institutions often target higher risk consumers and usually charge higher interest rates." Hogarth & Hilgert, *supra,* at 16.

The primary federal anti-predatory lending law, the Home Ownership and Equity Protection Act (HOEPA), has similarly failed to keep pace with the rise of abusive lending practices. Hogarth, & Hilgert, *supra,* at15. Congress passed HOEPA in 1994 as part of the Truth in Lending Act (TILA) to curtail the growth of predatory mortgage lending targeted at vulnerable consumers. 15 U.S.C. §§ 1602(aa)(2003).[8/] Lending in the subprime market, however, has escalated dramatically since the enactment of HOEPA in 1994. *See* Fed. Reserve Sys. Proposed Rule, 65 Fed. Reg. 42889 (2000).

Although HOEPA's passage has helped to provide additional protections for victims of predatory lending, it has not adequately remedied the problem because of its limited scope.[9/] When the Federal Reserve Board lowered the HOEPA APR interest rate trigger on first liens from 10 percent to 8 percent, HOEPA's coverage expanded from an estimated 1 percent of subprime loans to 5 percent. *See* Letter from FTC to Board of Governors of the Federal Reserve System of Mar. 9,

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[8/] HOEPA, among other things, prohibits creditors from engaging in certain abusive practices, and requires creditors to provide enhanced disclosures to consumers when making certain high cost loans. 15 U.S.C. §§ 1602(aa), 1639. For example, HOEPA prohibits a covered loan from: (1) including a balloon payment payable in less than five years, (2) including more than two prepayments, (3) including most prepayment penalties, (4) including negative amortization, (5) including an increased interest rate upon default, (6) being made without regard to a borrower's ability to repay the loan, and (7) disbursing funds solely to a home-improvement contractor. 15 U.S.C. §§ 1639 (c)-(i) (2003).

[9/] HOEPA covers loans with an APR at the time of consummation that exceeds by more than 8 percentage points the yield on U.S. Treasury securities having comparable maturities at the time the lender made the loan or total points and fees in excess of 8 percent of the total loan amount. 15 U.S.C. §§ 1602 (aa)(1)(A) and (B).

2001 regarding proposed HOEPA amendments, *at* http://www.ftc.gov/be/v010004.htm.[10/]

Currently many lenders, however, price their loans just below the HOEPA triggers,[11/] while retaining abusive lending practices. *FTC Report to Fed. Reserve Sys., supra*.[12/]

III. STATE LAWS SUCH AS S.C. CODE ANN. § 37-1-102 (2002) ENACTED TO PROTECT THE PUBLIC INTEREST PURSUANT TO STATE POLICE POWERS SHOULD BE AFFORDED GREAT DEFERENCE

A. Courts Broadly Construe State Consumer Protection Laws in Order to Effectuate Their Remedial Purpose to Adequately Protect Consumers from Unfair and Deceptive Business Practices

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[10/] The percent of loans covered by HOEPA under the credit industry's analysis is also very small. S*ee* Michael Staten & George Elliehausen, Am. Fin. Serv's Ass'n, *The Impact of the Federal Reserve Board's Proposed Revisions to HOEPA* (July 24, 2001), *available at* http://www.mbaa.org/industry/reports/01/afsa (finding that HOEPA covers 37.6 percent of first lien subprime loans).

[11/] Subrpime lenders have compensated for the lower rates by raising lender fees that are not included in the fees and costs trigger. Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 Tex. L. Rev. 1255, 1308 (May 2002).

[12/] Additionally, the FTC recently recommended the following changes in HOEPA so that the law may better address problems relating to predatory mortgage lending: Including coverage of open-end credit and "spurious open-end credit," limiting or prohibiting practices that are unfair, deceptive, or abusive, prohibiting loan flipping, limiting refinancing of HOEPA loans, limiting refinancing of certain low-rate loans, prohibiting "payable on demand" or "call" provisions, prohibiting asset-based lending, and enhancing disclosures. *FTC Report to Fed. Reserve Sys., supra.*

All fifty states and the District of Columbia have enacted consumer protection statutes with broad applicability to most consumer transactions. The statutes are designed to protect consumers from unfair, deceptive and abusive business practices in the marketplace. National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 1.1 (5th ed. 2001 & Supp. 2002). South Carolina, like most states, patterned its statute after the language in Section 5(a)(1) of the FTC Act, 15 U.S.C. § 45(a)(1) (2003), which provides in relevant part that "unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful." *See Johnson v. Collins Entm't Co.,* 349 S.C. 613, 564 S.E.2d 653 (2002). By incorporating the FTC Act's broad and expansive prohibition against unfair or deceptive practices affecting commerce, states enacted laws with potent private remedies providing wide-spread redress for marketplace abuses.

Consumer protection laws, such as S.C. Code § 37-10-102, are broadly interpreted by the courts in order to effectuate the statute's remedial purpose to protect the public from deceptive and unconscionable acts. *E.g., Tilley v. Pacesetter Corp.,* 333 S.C. 33, 508 S.E.2d 16, 19 n.6 (1998); s*ee also Davis v. NationsCredit Fin. Srvc. Corp.,* 326 S.C. 83, 484 S.E.2d 471, 472 (1997) .[13/] The purpose of South Carolina Consumer Protection Code is to protect consumers against unfair practices by suppliers of consumer credit.[14/] *Fanning v. Fritz's Pontiac-*

[13/] *See also, e.g., Showpiece Homes Corp. v. Assurance Co.*, 38 P.3d 47 (Colo. 2001); *Dressel v. Ameribank*, 247 Mich. App. 133, 635 N.W.2d 328 (2001); *Polonetsky v. Better Homes Depot, Inc.*, 97 N.Y.2d 46, 760 N.E.2d 1274, 735 N.Y.S.2d 479 (2001); *Smith v. Commercial Banking Corp*., 866 F.2d 576 (3rd Cir. 1989); *Iadanza v. Mather*, 820 F. Supp. 1371 (D. Utah 1993).

[14/] S.C. Code Ann. § 37-1-102 (2002) provides, in relevant part, that the law shall be liberally construed and applied to promote its underlying purposes and policies, which are:

> (c) to further consumer understanding of the terms of credit transactions and to foster competition among suppliers of consumer credit so that consumers may obtain credit at

(continued...)

Cadillac-Buick, Inc., 472 S.E.2d 242 (S.C. 1996). Green Tree, among other things, willfully and persistently violated South Carolina's Preference Statute, S.C. Code § 37-10-102, which is part of South Carolina's broader Consumer Protection Code, S.C. Code Ann. § 37-1-102 (2002). The Preference Statute was enacted to encourage consumers to have an advocate present at the signing of loan contracts so as to curtail lenders from foisting usurious and deceptive loans upon S.C. citizens.[15/] Accordingly, S.C. Code § 37-1-102 should be afforded great deference since it is designed to provide consumers with a powerful remedy to right commercial wrongs.

B. Many States Have Necessarily Enacted Laws Under Their Police Powers in Order to Deter Abusive Lending Practices, Protect Vulnerable Consumers from Unscrupulous Mortgage Lenders and Provide Redress for Victims in Response to the Devastating Effects of Predatory Lending

Since the emergence of predatory lending practices, many states have responded by studying, introducing and enacting additional consumer protections relating to high-cost home refinancing loans. The laws, which are typically an outgrowth

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[14/] (...continued)

reasonable cost;

(d) to protect consumer buyers, lessees, and borrowers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors;

(e) to permit and encourage the development of fair and economically sound consumer credit practices.

[15/] On February 25, 2003, the S.C. Gen. Assemb. introduced an anti-predatory lending Bill H 3616 entitled "South Carolina High-Cost and Consumer Home Loans Act." Among other things the Act: (1) Requires applicants for high-cost loans to get credit counseling; (2) Prohibits flipping, the refinancing of a loan without providing a tangible benefit to the borrower; and (3) Requires lenders to evaluate a consumer's ability to repay the debt. http://www.mbaa.org/resources/predlend/.

of each state's existing consumer protection statute, are a measured and permissible response to a public emergency and are enacted pursuant to the state's police powers. *See, e.g., Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 146 (1963) (holding that state laws designed to prevent the deception of consumers are well within the scope of a state's police powers).[16/] Since 1999, more than thirty-five states and municipalities have either passed or introduced anti-predatory lending laws.[17/] Most state laws are modeled after HOEPA and, therefore, do not set a cap on interest rates or fees. Instead, the laws apply only to "high cost" loans using HOEPA type triggers to calculate what loans are covered. Most state laws enacted or introduced prohibit the most egregious aspects of predatory lending, i.e., making unaffordable loans often referred to as asset-based lending, and loan flipping, which strips the equity in the home and often leads to foreclosure. Several states also include prohibitions against financing of points and fees in high cost loans, which deter mortgage brokers and lenders from charging exorbitant loan fees. Other practices prohibited include balloon payments, direct home-improvement disbursements, negative or non-amortizing loans, increased default interest rates, prepayment penalties, financing of credit insurance, encouraging default, and failing to use the borrowers' correct credit score. Anna Beth Ferguson, *Predatory Lending: Practices, Remedies and Lack of Adequate Protection for Ohio Consumers*, 48 Clev. St. L. Rev. 607 (2000); Deborah Goldstein, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 Harv. C.R.-C.L. L. Rev. 225 (Winter, 2000); Margot Saunders, *The Increase in Predatory Lending*

[16/] In an area of law traditionally occupied by the states, such as the exercise of a state's police powers, the Court begins with the presumption that these laws are not superseded by a federal act unless Congress' intent to preempt is clear and manifest. *California v. ARC America Corp.* 490 U.S. 93, 101 (1989).

[17/] *E.g.,* N.C. Gen. Stat. §24-1.1E and §24-10.2. (2003); D.C. Code § 26-1151(2002); Ill. Admin. Code tit. 38, §1050.110 (2003); N.Y. Comp. Codes & Regs. Tit. 3 §41.1 (2003); Tex. Const. Art. 16, §50(a)(6); Va. Code Ann. §§ §§6.1-413, 422-28 (2003); Cal. Fin. Code § 4970 (2003).

and Appropriate Remedial Actions, 6 N.C. Banking Inst. 111 (April 2002); Donna S. Harkness, *Predatory Lending Prevention Project: Prescribing a Cure for the Home Equity Loss Ailing the Elderly,* 10 B.U. Pub. Int. L.J. 1 (2000).[18]

In 1999, North Carolina was first to adopt a comprehensive predatory lending law applicable to high cost mortgage loans. The law prohibits the financing of single premium credit insurance, prepayment penalties for certain loans, and loan flipping. N.C. Gen. Stat. §24-1.1E, §24-10.2. (1999) In 2002, the Center for Responsible Lending released a study regarding the effects of North Carolina's predatory lending law. Using data from the Home Mortgage Disclosure Act (HMDA), industry pricing, secondary market, U.S. Census Bureau and HUD, the Report concludes that predatory lending practices have decreased in North Carolina while maintaining full access to a wide range of credit choices, including subprime loans, for the state's homeowners**.** Keith Ernst, John Farris, Eric Stein, *North Carolina's Subprime Home Loan Market After Predatory Lending Reform: A Report from the Center for Responsible Lending* (August 13, 2002), *at* http://predatorylending.org/ pdfs/081302_CRL_study_FINAL.pdf.

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[18] The status of pending state laws is changing almost daily. For example, from Jan. - Mar. 2003, bills were introduced in N.Y. (AB 5057/AB 5167), Me. (LD 494, AR HB 1668/HB 4214), R.I. (H8029), Ill. (SB 497, MD SB 574), N.H. (HB 817/SB 99/ SB 122/HB 504), Utah (HB 189), Haw. (HB 1438/HB 1329/HB 374), Ind. (HB1698/HB 1841/SB 478), Ariz. (HB 2468), S.C. (H 3616), Okla. (HB 1585), N.M. (SB 449), Miss. (SB 2830/HB 1458), Idaho (HB 28), Tenn. (HB 1076 /SB 0743/SB 203 /HB 21), Ky. (HB 287), Va. (SB 1103), Mich. (HB 6121), Ga. (HB 146/ SB 53/ SB 78), Tex. (HB 1079 SB 252), Wash. (SB 5671/SB 5672). *See* http://www.mbaa.org/resources/predlend. *See also* Office of Thrift Supervision (OTS) letters of January 2003 (finding that provisions of Georgia's and New York's predatory lending laws do not apply to federal savings associations and their operating subsidiaries), *available at* http://www.ots.treas.gov/docs/77302.html; and http://www.ots.treas.gov/ docs/77304.html.

C. Private Attorney General Enforcement Is Pivotal To The Enforcement of State Consumer Protection Laws

Private attorney general lawsuits are necessary to further the remedial purposes of state consumer protection laws. *Noack Enter., Inc. v. Country Corner Interiors of Hilton Head Island*, 290 S.C. 475, 351 S.E.2d 347 (Ct. App. 1986); *Baierl v. McTaggart*, 245 Wis. 2d 632, 629 N.W.2d 277 (2001) (noting that consumers acting as private attorneys general are a necessary supplement to state enforcement actions given the limited resources available to the state). Every state legislature, therefore, except Iowa, includes a private right of action in its consumer protection law.[19/] National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 7.2.1 (5th ed. 2001 & Supp. 2002). Simply legislating prohibited conduct could not, by itself, remedy the vast disparity in bargaining positions between consumers and businesses such as credit finance companies. Private attorneys general actions "ensure the vindication of important rights... ." *Farrar v. Hobby*, 506 U.S. 103, 122 (1992) (O'Connor, J. concurring). Petitioners and their *amici* advocate upsetting this statutory framework by allowing creditors to impose an arbitration scheme that thwarts consumers' ability to vindicate their rights under state consumer protection laws.

[19/] Most state consumer protection laws also provide for injunctive relief, consequential, multiple, minimum or punitive damages, and attorneys fees in order to encourage consumers to initiate a claim. See National Consumer Law Center, *Unfair and Deceptive Acts and Practices* § 8.1 (5th ed. 2001 & Supp. 2002). Congress similarly designed the federal Truth in Lending Act, one of the most significant federal consumer protection laws, to create enforcement through a system of private attorneys general. *See, e.g., Edwards v. Your Credit, Inc.*, 148 F.3d 427 (5th Cir. 1998); *McGowan v. King, Inc.*, 569 F.2d 845, 848 (5th Cir. 1978); *Aquino v. Public Fin. Consumer Discount Co.*, 606 F. Supp. 504, 508 (E.D. Pa. 1985); *French v. Wilson*, 446 F. Supp. 216 (D.R.I. 1978).

1. Class Actions Are an Essential Vehicle for Facilitating Private Attorney General Actions

Consumer claims often are brought for small dollar amounts to remedy deceptive practices aimed at the most vulnerable members of our society. Class actions were designed to be brought by "impecunious plaintiffs who allege similar mistreatment by a comparatively powerful defendant, one that . . . otherwise might get away with piecemeal highway robbery by committing small violations that were . . . beyond [the] ability or resources [of individual plaintiffs] to remedy." *Jackson v. Check' N Go, Inc.*, No. 99-C-7319, 2000 U.S. Dist. LEXIS 8352 at *9 (N.D. Ill. June 13, 2000).

The Court has endorsed the important role of class actions:

> The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.

Amchem Products, Inc. v. Windsor, 521 U.S. 591, 617 (1997) (citation omitted). *Accord Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) (reasoning that "[a] critical fact . . . is that petitioner's individual stake . . . is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all.").

2. Arbitration Provisions Inserted Into Consumer Adhesion Contracts That Preclude Class Actions Undermine Private Attorney General Enforcement of Important State Consumer Protection

Laws Thereby Thwarting Their Remedial Purpose

a. Concurrent with the Growth of Predatory Lending is the Pervasive Use of Mandatory Binding Arbitration Clauses in Consumer Adhesion Finance Contracts

Concurrent with the growth of predatory lending is the pervasive use of mandatory binding arbitration clauses in consumer adhesion finance contracts. *See* Jean R. Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to that of the Rest of the World*, 56 U. Miami L. Rev. 831 (2002) (noting that companies are increasingly using contracts of adhesion to require consumers to resolve any disputes with the company through private binding arbitration rather than in court.)[20]

The current trend of lenders and other businesses to impose binding pre-dispute arbitration on their customers in order to prevent class action litigation is indisputable. *See* Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?* 42 Wm. & Mary L. Rev. 1 (2000). Green Tree's employment of this strategy to avoid legal consequences for its lending practices cannot be countenanced. Having successfully forced many lawsuits into the arbitral forum where consumers have challenged Green Tree's lending practices,[21] Petitioners are now actively seeking

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[20] "Consumer contract law should not be based on the false notion that by signing ... form [adhesion] contracts, the consumer knows of, understands, and has assented to the terms of the writing. New approaches are needed to truly protect consumers and to give judges the ability to police consumer agreements ... [T]he legal system is ... turning a blind eye to the realities of the marketplace and to the fact that consumers cannot understand and do not actually assent to the terms of the consumer contracts they sign." Alan M. White & Cathy Lesser Mansfield, *Article: Literacy and Contract*, 13 Stan. L. & Pol'y Rev. 233, 266 (2002).

[21] *E.g.*, *Harris v. Green Tree Fin. Corp.*, 183 F.3d 173 (3d Cir. 1999), *Pridgen v. Green Tree Fin. Serv. Corp.*, 88 F. Supp. 2d 655 (S.D. Miss.

(continued...)

to undermine private attorney general enforcement of important consumer laws by depriving claimants their right to pursue their claims as class actions. If consumers are forced into the arbitral forum without the right to seek class-wide relief, creditors will be able to avoid statutory compliance with impunity. *See In re Knepp*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999) (finding that "[t]he pervasive use of arbitration agreements in consumer contracts could have the effect of eliminating class actions. If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy").

CONCLUSION

The Federal Arbitration Act, 9 U.S.C. § 1 (2003), *et seq.*, does not preempt consumers' rights to consolidate claims under state consumer protection laws that are enacted pursuant to a state's police powers. Consumers who are required to pursue their consumer claims in arbitration must be afforded their full rights and remedies, including the pursuit of class action claims. As long as these rights, remedies, and protections are not afforded under arbitration agreements, consumers must be permitted their day in court. To find otherwise would leave consumers unprotected and without any recourse from one of the most devastating consumer abuses: the loss of one's home through unfair and deceptive practices. AARP, therefore, urges the Court to uphold the decision below of the Supreme Court of South Carolina.

March 26, 2003

Respectfully submitted,

Stacy Canan*
Deborah Zuckerman
Nina Simon
Jean Constantine-Davis

Michael R. Schuster
AARP

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[21] (...continued)
2000), *Green Tree Fin. Corp. v. Holt*, 171 U.S. Dist. LEXIS 11765 (N.D. Ala. 1997).

AARP Foundation

601 E Street, N.W.
Washington, DC 20049
(202) 434-2060

Counsel for *Amicus Curiae*
AARP