

2006

# Improvident Extension of Credit as an Extension of Unconscionability: Discover Bank v. Owens and a Debtor's Rights against Credit Card Companies

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### Recommended Citation

Note, Improvident Extension of Credit as an Extension of Unconscionability: Discover Bank v. Owens and a Debtor's Rights against Credit Card Companies, 54 Clev. St. L. Rev. 435

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IMPROVIDENT EXTENSION OF CREDIT AS AN EXTENSION  
OF UNCONSCIONABILITY: *DISCOVER BANK V. OWENS*<sup>1</sup> AND A  
DEBTOR’S RIGHTS AGAINST CREDIT CARD COMPANIES

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<sup>1</sup>822 N.E.2d 869 (Ohio Mun. Ct. Clev. 2004).

## I. INTRODUCTION

We receive them in the mail every day: materials from credit card companies, ranging from applications to cards pre-printed with our names and information. Most of us understand these unsolicited mailings to be mere attempts to gain business. But imagine that you are poor, uneducated, perhaps even mentally ill, and you have trouble providing for yourself and your family. Will you understand the significance of a credit card and its underlying responsibility? Should you be expected to? You did not request the card and may even believe it to be a gift or a form of assistance. You call the number on the back of the card to activate it and begin charging necessities for your family. You may charge only a few dollars, or perhaps you charge thousands of dollars worth of goods and services. Either way, you cannot possibly pay off the amount, so the bill continues to grow with fees and interest. Over time, you owe more money in fees and interest than you ever charged. Should you be responsible for your charges, interest, and fees?

Some attorneys encounter this very situation every day: people who have very little money ring up thousands of dollars in credit card bills. They may or may not understand the workings of a credit card, but none of them can pay the bill. Some of these individuals have done this before; they are repeat offenders who are on payment plans or who have already had their debts discharged in bankruptcy. Yet they still receive credit card applications every day, some from the same companies with which they have previously had credit card problems. Is there a point where some of the responsibility should shift to the credit card companies?

Yes, responsibility should shift to the credit card company through the doctrine of improvident extension of credit. As defined by Vern Countryman,<sup>2</sup> an improvident extension of credit is:

[A] contractual extension of credit to a debtor where it cannot reasonably be expected that the debtor can repay the debt according to the terms of the agreement . . . in view of the circumstances of the debtor at the time credit was extended as these circumstances were known to the creditor or would have been revealed to him on reasonable inquiry prior to credit extension.<sup>3</sup>

Improvident extension of credit, discussed heavily in the 1960s and 1970s, has resurfaced as a defense to breach of contract claims in recent years. The defense is

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<sup>2</sup>Vern Countryman was a professor at Harvard Law School and a specialist in commercial law, bankruptcy law and reform, secured transactions law, and civil liberties. *HLS' Vern Countryman Dies*, HARVARD UNIVERSITY GAZETTE, May 13, 1999, available at <http://www.hno.harvard.edu/gazette/1999/05.13/Countryman.obit.html>. Countryman not only defined improvident extension of credit, but was an advocate for its codification for decades. Margaret Howard, *Vern Countryman and Barry Zaretsky: A Legacy of Ideas*, 75 AM. BANKR. L.J. 283, 294 (2001). Ultimately, he was unsuccessful in his attempts to introduce the concept into law. *Id.* Countryman has been called "a voice in the wilderness, although everything he said twenty and thirty years ago still has relevance today." *Id.*

<sup>3</sup>Vern Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1, 23 (1975).

largely unsuccessful, and creditors generally prevail in cases against debtors.<sup>4</sup> However, in 2004, a municipal court judge in Cleveland, Ohio proved to be sympathetic to an impoverished debtor representing herself against a large credit card company.<sup>5</sup> The judge<sup>6</sup> did not use the term improvident extension of credit, but the theory resonates in the judge's rationale. While Vern Countryman and his colleagues did not discuss credit card lending in terms of improvident extension of credit,<sup>7</sup> this doctrine and its underlying theories should be extended to all consumer credit, including credit card lending, in the form of federal statutory law or in the alternative, favorable court decisions for the debtor.

This note will examine improvident extension of credit as an extension of unconscionability in consumer credit card lending. Part II of this note will discuss the history and foundation of unconscionability. Part III will discuss the history and foundation of improvident extension of credit, as well as the many failed attempts to create a solution to the problem of improvident extension of credit in the United States. Part IV of this note will analyze the current role of improvident lending in consumer credit and why no solution was reached in the 1970s. Part V will examine the increased need for consumer protection in the last few decades. Part VI will discuss the inadequate solutions proposed to resolve the issue of improvident extension of credit in society. Part VII will examine *Discover Bank v. Owens*,<sup>8</sup> a recent case holding in favor of a debtor. Finally, Part VIII will discuss the need to readdress the lack of statutory law on the subject of improvident extension of credit and offer several possible solutions.

## II. UNCONSCIONABILITY

The common law doctrine of unconscionability represents a departure from the traditional *caveat emptor* philosophy taken by the judicial system. In 1966, Judge Hyman Korn of the Supreme Court of New York said that “[w]e have reached the point where ‘Let the buyer beware’ is a poor business philosophy for a social order allegedly based upon man’s respect for his fellow man. Let the seller beware, too! A free enterprise system not founded upon personal morality will ultimately lose freedom.”<sup>9</sup> Unconscionability has been defined and explained in many paramount

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<sup>4</sup>See, e.g., *Gill v. Nelnet Loan Servs. (In re Gill)*, 326 B.R. 611 (Bankr. E.D. Va. 2005) (holding debtor's obligation for a loan taken out to finance daughter's college education was nondischargeable under 11 U.S.C. § 523(a)(8) (2000) because debtor did not prove she would be unable to maintain minimal standard of living if required to repay loan balance); *Lee v. Bank One (In re Lee)*, 249 B.R. 864 (Bankr. N.D. Ohio 2000) (holding debtor did not carry his burden of proof to avoid the lien).

<sup>5</sup>*Discover Bank*, 822 N.E.2d at 871.

<sup>6</sup>Former Cleveland Municipal Court Judge Robert J. Triozzi.

<sup>7</sup>Countryman, *supra* note 3, at 17.

<sup>8</sup>822 N.E.2d 869.

<sup>9</sup>*State v. ITM, Inc.*, 275 N.Y.S.2d 303, 321 (N.Y. Trial Term 1966); see also *Nu Dimension Figure Salons v. Becerra*, 340 N.Y.S.2d 268, 273 (N.Y. Trial Term 1973) (“The term *caveat emptor* has been eroded by the code. No longer can a seller hide behind it when acting in an unconscionable manner.”).

cases. Two such cases include *Toker v. Westerman*<sup>10</sup> and *Williams v. Walker-Thomas Furniture Co.*<sup>11</sup>

First, in *Toker*, the New Jersey District Court defined an unconscionable contract as:

[O]ne such as no man in his senses and not under a delusion would make on the one hand, and as no honest and fair man would accept on the other. To what extent inadequacy of consideration must go to make a contract unconscionable is difficult to state, except in abstract terms, which gives but little practical help. It has been said that there must be an inequality so strong, gross, and manifest that it must be impossible to state it to a man of common sense without producing an exclamation at the inequality of it.<sup>12</sup>

The United States Court of Appeals for the District of Columbia Circuit developed its own definition of unconscionability in *Williams*. The court looked to similar cases for guidance, including those cited in the Official Comments of § 2-302 of the Uniform Commercial Code (UCC), discussed below, such as *Henningsen v. Bloomfield Motor, Inc.*<sup>13</sup> The court set forth the common law doctrine of unconscionability in the District of Columbia and recognized it to include both an absence of meaningful choice on the part of one party and contract terms that are unreasonably favorable to the other party.<sup>14</sup> The court explained that the existence of a meaningful choice could only be determined by considering all of the circumstances surrounding the transaction.<sup>15</sup> Even if a meaningful choice exists in a transaction, it could be negated by a gross inequity of bargaining power.<sup>16</sup>

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<sup>10</sup>274 A.2d 78 (N.J. Dist. Ct. Union County 1970). In this case, a door-to-door salesman sold a refrigerator-freezer to the purchaser under a retail installment contract for \$1,229.76. *Id.* The purchaser made payments for a period of time but refused to pay the balance owed, claiming that the refrigerator was so overpriced as to make the contract unenforceable. *Id.* The court found that the contract was unconscionable because the sale was for approximately two and a half times the reasonable retail value. *Id.*

<sup>11</sup>350 F.2d 445 (D.C. Cir. 1965). In this case, the buyers entered into installment contracts with the furniture company for the sale of furniture. *Id.* The buyers defaulted on their payments, and the district court granted judgment in favor of the company. *Id.* On appeal, the buyers contended that their contracts with the company were unenforceable due to unconscionability. *Id.* The court held that it had the authority to refuse to enforce a contract found to be unconscionable at the time it was made and reviewed the contract to consider the contract's terms in light of the general commercial background and the commercial needs of the particular trade or case. *Id.* The court determined, however, that neither the trial court nor the appellate court made findings on the possible unconscionability of the contracts, and thus, the cases were remanded to the trial court for further proceedings. *Id.*

<sup>12</sup>274 A.2d at 80. The origin of the definition appears to be the case of *Earl of Chesterfield v. Janssen*, 28 Eng. Rep. 82 (1750). Ronald L. Hersbergen, *The Improvident Extension of Credit as an Unconscionable Contract*, 23 DRAKE L. REV. 225, 290 n.271 (1974).

<sup>13</sup>161 A.2d 69 (N.J. 1960).

<sup>14</sup>*Williams*, 350 F.2d at 449.

<sup>15</sup>*Id.*

<sup>16</sup>*Id.*

Moreover, the court determined that the manner in which the contract was entered into is an important factor for consideration.<sup>17</sup> The court asked whether “each party to the contract, considering his obvious education or lack of it, [had] a reasonable opportunity to understand the terms of the contract,” or whether the terms were “hidden in a maze of fine print and minimized by deceptive sales practices.”<sup>18</sup> The court further explained that, generally, when a party signs an agreement without full knowledge of its terms, the party may be held to have assumed the risk of entering a one-sided bargain.<sup>19</sup> However, when a party has little bargaining power, and therefore little choice, and signs a commercially unreasonable contract with little or no knowledge of its terms, it is unlikely that the party’s consent, or even an objective manifestation of consent, was ever really given to all of the terms.<sup>20</sup> In such a case, the general rule should be abandoned, and the court should consider whether the terms of the contract are so unfair that the contract should not be enforced.<sup>21</sup>

Finally, when determining reasonableness or fairness, the primary consideration must be the terms of the contract in light of the circumstances existing when the contract was made.<sup>22</sup> The court suggested that this could be achieved by examining the terms “in light of the general commercial background and commercial needs of a particular trade or case.”<sup>23</sup> The court quoted Corbin,<sup>24</sup> who suggested that where no meaningful choice is exercised upon entering the contract, the test should be whether the terms are “so extreme as to appear unconscionable according to the mores and business practices of the time and place.”<sup>25</sup>

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<sup>17</sup>*Id.*

<sup>18</sup>*Id.*

<sup>19</sup>*Id.*

<sup>20</sup>*Id.*

<sup>21</sup>*Id.* at 449-50.

<sup>22</sup>*Id.* at 450.

<sup>23</sup>*Id.*

<sup>24</sup>Arthur Linton Corbin (1874-1967) was a professor of contracts and other subjects at Yale Law School for forty years. He authored, among other things, *Corbin on Contracts*, a classic treatise which is cited by law students and judges alike. He also contributed as Special Advisor and Reporter for the chapter on remedies of the first Restatement of Contracts.

<sup>25</sup>*Williams*, 350 F.2d at 450; *see also* *Kugler v. Romain*, 279 A.2d 640 (N.J. 1971). In *Kugler*, the Supreme Court of New Jersey discussed unconscionability:

Unconscionability . . . is an amorphous concept obviously designed to establish a broad business ethic. The framers of the Code naturally expected the courts to interpret it liberally so as to effectuate the public purpose, and to pour content into it on a case-by-case basis. In that way a substantial measure of predictability will be achieved and professional sellers of consumer goods as well as draftsmen of contracts for their sale to ordinary consumers will become aware of the abuses the courts have declared unacceptable and will avoid them. The intent of the clause is not to erase the doctrine of freedom of contract, but to make realistic the assumption of the law that the agreement has resulted from real bargaining between parties who had freedom of choice and understanding and ability to negotiate in a meaningful fashion.  
*Id.* at 651-52.

Besides being a common law defense, unconscionability is also a statutory defense to breach of contract claims. Unconscionability, as codified in UCC § 2-302, states that if the court, as a matter of law, finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable clause, or limit the application of any unconscionable clause to avoid an unconscionable result.<sup>26</sup> This section “permits a court to accomplish directly what heretofore was often accompanied by construction of language, manipulations of fluid rules of contract law and determinations based upon a presumed public policy.”<sup>27</sup> The basic test for unconscionability is set forth in Official Comment 1 to § 2-302: “whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.”<sup>28</sup> While the Uniform Commercial Code forbids unconscionable clauses in contracts, it fails to define what “unconscionable” actually means. Courts often look to the common law definitions from such cases as *Toker* and *Williams*, discussed above.

While § 2-302 of the UCC has been used extensively by courts to police unconscionable agreements, it is not a consumer protection enactment.<sup>29</sup> In order for the UCC to apply, the agreement must involve a transaction of goods.<sup>30</sup> Thus, consumer loans, consumer leases, and the sale of consumer services or land are not covered by this section.<sup>31</sup> Another doctrine began to develop that would similarly protect consumers but would also apply to contracts that did not involve the sale of goods: the doctrine of improvident extension of credit.

### III. THE HISTORY OF IMPROVIDENT EXTENSION OF CREDIT

While first popular in the 1960s and ‘70s, improvident extension of credit has been a concern since the days of Plato. Plato, speaking through Socrates in the *Republic*, posited that in an oligarchical state, one in which the “government rest[s] on a valuation of property, in which the rich have power and the poor man is deprived of it,” the “greedy ‘men of business’ would acquire property [by] lending at extravagant rates,” and the debtors would be forced to respond in revolution.<sup>32</sup>

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<sup>26</sup>U.C.C. § 2-302 (2005).

<sup>27</sup>*Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264, 266 (N.Y. Sup. Ct. 1969).

<sup>28</sup>U.C.C. § 2-302 cmt. 1.

<sup>29</sup>Hersbergen, *supra* note 12, at 289.

<sup>30</sup>*Id.*

<sup>31</sup>*Id.*

<sup>32</sup>Howard, *supra* note 2, at 295 & n.73 (quoting PLATO, *THE REPUBLIC*, Book VIII, at 550c-550d). Plato wrote:

And in oligarchical States, from the general spread of carelessness and extravagance, men of good family have often been reduced to beggary?

Yes, often.

And still they remain in the city; there they are, ready to sting and fully armed, . . . and they hate and conspire against those who have got their property, and against everybody else, and are eager for revolution.

While those writing about improvident extension of credit in the 20th century did not see quite as dire consequences as Plato, they shared his desire to place some of the responsibility on the creditors.<sup>33</sup> Beginning in the 1930s, several attempts were made to codify the doctrine of improvident extension of credit, including the proposed Model State Collection Act, the National Bankruptcy Conference Committee, the Uniform Consumer Credit Code, and the National Commission on Consumer Finance. Most of these attempts stemmed from the area of bankruptcy law; however, none of these attempts were completely successful in capturing Countryman's original concept of improvident extension of credit.<sup>34</sup>

#### A. Model State Collection Act

One of the first proposals to codify improvident extension of credit came from Professor Wesley Sturges in 1934.<sup>35</sup> Sturges authored a Model State Collection Act that was published in the *Yale Law Journal*<sup>36</sup> but adopted nowhere.<sup>37</sup> Sturges wrote: "All too frequently, stable retail credit obligations, predicated upon conservative credit extensions, are brought to default or bankruptcy because a subsequent credit-grantor indulges first in high pressure salesmanship whereby the debtor is over sold and then in ruthless collection methods."<sup>38</sup> He also quoted the discussion of

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That is true.

On the other hand, the men of business, stooping as they walk, and pretending not even to see those whom they have ruined, insert their sting—that is, their money—into some one else who is not on his guard against them, and recover the parent sum many times over multiplied into a family of children: and so they make drone and pauper abound in the State.

Yes, he said, there are plenty of them—that is certain.

The evil blazes up like a fire; and they will not extinguish it, either by restricting a man's use of his own property, or by another remedy:

What other?

One which is the next best, and has the advantage of compelling the citizens to look to their characters:—Let there be a general rule that every one shall enter into voluntary contracts at his own risk, and there will be less of this scandalous money-making, and the evils of which we are speaking will be greatly lessened in the State.

*Id.* at 295 (quoting PLATO, *THE REPUBLIC*, Book VIII, at 555d-556b).

<sup>33</sup>“Plato's remedies—restricting property owners' unbridled freedom to use their property and placing the risks flowing from voluntary contracts on creditors—have clear, albeit imperfect, parallels in bankruptcy law today.” *Id.*

<sup>34</sup>Countryman, *supra* note 3, at 18.

<sup>35</sup>*Id.* at 7.

<sup>36</sup>Wesley A. Sturges, *A Proposed State Collection Act*, 43 *YALE L.J.* 1055 (1934).

<sup>37</sup>Countryman, *supra* note 3, at 8. Countryman enumerated several defects with Sturges's proposal. *Id.* He first noted that the act created incentives for other creditors to bring about a complete liquidation of the debtor's estate when one creditor moved to collect his claim. *Id.* Moreover, each general creditor was expected to have complete knowledge of the debtor's financial position, an unreasonable expectation. *Id.* Finally, any creditor with a security interest would prevail over general creditors, regardless of when the secured creditor extended credit. *Id.*

<sup>38</sup>Wesley A. Sturges & Don E. Cooper, *Credit Administration & Wage Earner Bankruptcies*, 42 *YALE L.J.* 487, 524 (1933).



overloading debtors from the Thatcher Report,<sup>39</sup> setting forth the principle that creditors themselves are often to blame for the losses they incur because credit is extended carelessly and without adequate inquiry or with the expectation that the profits from the increased volume of sales will exceed the probable credit losses.<sup>40</sup> Regardless of the credit risk, the consequences of increasing sales by encouraging people of moderate and low income to make purchases on credit that they cannot afford are shown in the bankruptcy statistics.<sup>41</sup> Unfortunately, the losses from bankruptcy are shared by all creditors equally.<sup>42</sup> The Thatcher Report also provided an illustration of this principle:

The situation is well illustrated in the case of wage earners who, in large numbers, seek discharge from their debts in bankruptcy because they have been induced by one group of creditors at the expense of another to buy luxuries they cannot afford. These debtors either because of the more active collection methods of dealers in luxuries or in order to retain property sold to them under conditional sales contracts, often satisfy their debts owing for luxuries and seek discharge in bankruptcy from debts owing to the butcher, the baker, the grocer and the doctor, who had no part in bringing about their insolvency.<sup>43</sup>

As part of the proposed act, unsecured contractual creditors would be entitled to priority payment from a debtor's estate in the order in which they extended credit.<sup>44</sup> Furthermore, when one creditor brought an action to collect his claim, other creditors could join in the same action and assert their priorities.<sup>45</sup> From the Model State Collection Act, it is apparent that a solution to the problem of improvident extension of credit, while not termed such, has been sought for many decades.

*B. National Bankruptcy Conference Committee*

"In 1965, the National Bankruptcy Conference (NBC)<sup>46</sup> created a special committee, [chaired by Vern Countryman,] to propose improvements in wage earner

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<sup>39</sup>In 1929, as a consequence of a number of grand jury indictments for bankruptcy frauds, District Judge Thomas D. Thacher conducted an investigation of over 4000 witnesses, creating the "Donovan Report," named after the counsel for the bar associations that participated in the investigation. Countryman, *supra* note 3, at 6 n.28. Thacher became Solicitor General of the United States and directed a nationwide survey by the Department of Justice to produce the "Thacher Report." *Id.*

<sup>40</sup>*Id.* (citing STRENGTHENING OF PROCEDURE IN THE JUDICIAL SYSTEM, S. DOC. NO. 72-65 (1st Sess. 1932)).

<sup>41</sup>*Id.* at 6-7.

<sup>42</sup>*Id.*

<sup>43</sup>*Id.* at 7.

<sup>44</sup>Sturges, *supra* note 36, at 1080.

<sup>45</sup>*Id.* at 1076.

<sup>46</sup>The National Bankruptcy Conference is a voluntary, non-profit, self-supporting organization of about 65 lawyers, law teachers, and bankruptcy judges who have achieved scholarly distinction in the field of bankruptcy law. National Bankruptcy Conference, [www.nationalbankruptcyconference.org/mission.htm](http://www.nationalbankruptcyconference.org/mission.htm) (last visited Dec. 26, 2005). The

proceedings under Chapter XIII of the Bankruptcy Act.”<sup>47</sup> The committee recommended a proposed bill that would have added, among other things, two new provisions to Chapter XIII:

(1) On application of the debtor and after hearing on notice to the creditor concerned, the court might determine that a claim, secured or unsecured, was unconscionable or contained unconscionable terms, and might disallow such claim and order it excluded from the wage earner plan, or allow the claim without the unconscionable terms, or so limit the claim as to avoid any unconscionable result. . . .<sup>48</sup>

(2) On application of the debtor and after hearing on notice to the creditor concerned, the court might determine that a claim, secured or unsecured, was based on “an improvident extension of credit in view of the information reasonably available to the creditor at the time of extending credit, and such claim may then be separately provided for in the plan, or may be excluded from the plan, and if excluded from the plan shall not be deemed dealt with by the plan.”<sup>49</sup>

The NBC approved the proposal on unconscionability, but not the improvident credit extension provision.<sup>50</sup>

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purpose of the Conference is to study bankruptcy laws and draft proposals for their reform. *Id.* The organization was formed in the 1940s by leading scholars who assisted Congress in drafting the Chandler Act of 1938, the first comprehensive revision of the Bankruptcy Act of 1898. *Id.* Since its formation, the Conference has monitored the operation and practice of bankruptcy law and has consulted with Congress in every substantial amendment to the Bankruptcy Act up to the 1970s. *Id.*

<sup>47</sup>Countryman, *supra* note 3, at 8. The proposed improvements were to be an alternative to a bill, H.R. 292, 89th Cong. (1965) (1st Sess.), sponsored by the American Bar Association Consumer Bankruptcy Committee, providing for compulsory Chapter XIII proceedings. Countryman, *supra* note 3, at 8.

<sup>48</sup>Countryman, *supra* note 3, at 8-9. The first proposal went on to explain: This proposal was modeled on § 2-302 of the Uniform Commercial Code (UCC) but that section is confined in its application to “transactions in goods.” While the concept of unconscionability did not originate with the UCC, and has been employed by courts to test personal service contracts and loan agreements, judicial development of the concept had been spotty and the intent of the proposal was to give the Chapter XIII court a clear statutory base for testing any claim for unconscionability regardless of development of state law on the subject. *Id.* at 9.

<sup>49</sup>*Id.* The second proposal explained that “[t]his proposal, unlike the one dealing with unconscionability had no precedent in case law or statute.” *Id.*

<sup>50</sup>*Id.* at 9-10. Countryman explained that the proposal on improvident credit extension was flawed for two reasons. *Id.* at 10. First, there was no reason for confining it to Chapter XIII cases. *Id.* Second, it was unclear whether an improvident claim excluded from the plan would be covered by the bankruptcy discharge because a discharge in a Chapter XIII case applies only to debts provided for in the plan. *Id.*

*C. Uniform Consumer Credit Code*

In 1968, the American Bar Association's National Conference of Commissioners on Uniform State Laws promulgated the Uniform Consumer Credit Code (UCCC).<sup>51</sup> Section 5.108 extended the unconscionability "provisions of UCC § 2-302 to any consumer credit sale, consumer lease, or consumer loan."<sup>52</sup> Similar to the UCC, the UCCC does not define the term unconscionable; however, it does list five factors for consideration.<sup>53</sup> The first factor encompasses the idea of improvident extension of credit: "belief by the creditor at the time consumer credit sales, consumer leases, or consumer loans are made that there was no reasonable probability of payment in full of the obligation by the debtor."<sup>54</sup> The UCCC was only adopted in twelve states, and much of it became preempted or unnecessary by the federal Truth in Lending Act.<sup>55</sup>

*D. National Commission on Consumer Finance*

At the beginning of the 1970s, the National Commission on Consumer Finance (NCCF) conducted an inquiry into the concept of improvident extension of credit.<sup>56</sup> Vern Countryman was questioned by the Commission's counsel and provided them with a general standard.<sup>57</sup> He felt that when a bankruptcy court considers whether a consumer credit transaction is unconscionable, in addition to the law, it should consider whether the transaction entailed an improvident extension of credit.<sup>58</sup> The court should determine whether the creditor made an extension of credit to a debtor where it cannot reasonably be expected that the debtor can repay the debt in full, in view of the circumstances of the debtor as known to the creditor and of such circumstances as would have been revealed to him upon reasonable inquiry prior to the credit extension.<sup>59</sup> The Commission adopted Countryman's standard test but submitted no proposed legislation.<sup>60</sup> Instead, the Commission endorsed the idea,

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<sup>51</sup>*Id.* at 10.

<sup>52</sup>*Id.*

<sup>53</sup>*Id.*

<sup>54</sup>*Id.* (quoting UNIFORM CONSUMER CREDIT CODE § 6.111(3)(a) (1969 Revised Final Draft)). Similar to the UCCC, The National Consumer Act of 1970, drafted by the National Consumer Law Center, provides for nonenforcement of unconscionable consumer credit transactions and contains a longer list of factors to be taken into consideration. *Id.* at 11. However, the National Consumer Act never addresses improvident extension of credit. *Id.*

<sup>55</sup>Jean Braucher, *Deadlock: Consumer Transactions Under Revised Article 9*, 73 AM. BANKR. L.J. 83, 115 (1999).

<sup>56</sup>Countryman, *supra* note 3, at 12.

<sup>57</sup>*Id.*

<sup>58</sup>*Id.* at 13.

<sup>59</sup>*Id.* at 13-14.

<sup>60</sup>*Id.* at 13.

previously seen in the UCCC, that improvident extension of credit should be treated as a piece of unconscionability.<sup>61</sup>

*E. Vern Countryman's Proposal*

Vern Countryman recognized that it takes two offending parties to complete an improvident transaction.<sup>62</sup> However, he believed that creditors are in a better position to avoid and distribute the risk of loss of improvidence due to education, experience, resources, and the nature of their role.<sup>63</sup> To place the risk of loss on the improvident creditor, a remedy must be conferred on the improvident debtor.<sup>64</sup> Countryman posited that improvident extension of credit should be available to debtors to be used as both a defense and as a basis for affirmative relief.<sup>65</sup>

According to Countryman, debtors should be permitted to assert improvident extension of credit as a defense in bankruptcy and nonbankruptcy cases.<sup>66</sup> The defense should apply only to the part of the claim recognized as being improvident, not to the entire claim.<sup>67</sup> When timely asserted by debtors, the defense would provide a remedy for not only debtors, but their other creditors as well.<sup>68</sup>

There are some instances when relieving debtors of their obligation to repay improvident credit extensions will not remedy the damage done to debtors or to their other creditors.<sup>69</sup> Due to the improvident debt, debtors "may have fallen into arrears on . . . other debts," or may have been unable to provide for their families.<sup>70</sup> For this

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<sup>61</sup>*Id.* Countryman also prepared and submitted a paper to the Commission on the Bankruptcy Laws of the United States. *Id.* at 14. The paper addressed both improvident and unconscionable credit extension and suggested that both concepts should be uniformly incorporated in the bankruptcy law through amendments to the Bankruptcy Act. *Id.* In 1973, the Commission filed a report and revised the Bankruptcy Act of 1973. *Id.* Section 4-403(b)(8) of the Act provided for the disallowance of a consumer debt that was unconscionable. *Id.* at 15. Section 4-403(c) set forth three factors to be considered in determining unconscionability. *Id.* To Countryman's dismay, none of the factors focused on improvident extension of credit. *Id.* The third factor, however, incorporated nonbankruptcy law on the subject by authorizing the consideration of "definitions of unconscionability in statutes, regulations, rulings, and decisions of State and federal legislative, administrative, and judicial bodies." *Id.*; see also Vern Countryman, *The Use of State Law in Bankruptcy Cases*, 47 N.Y.U. L. REV. 407, 631 (1972).

<sup>62</sup>Countryman, *supra* note 3, at 17. Countryman wrote: "[A]s with the Tango it takes two to be improvident—any credit extension which is improvident on the part of the creditor is equally improvident on the part of the debtor." *Id.*

<sup>63</sup>*Id.*

<sup>64</sup>*Id.*

<sup>65</sup>*Id.* at 18, 20.

<sup>66</sup>*Id.* at 18. The defense must be applied to nonbankruptcy law because not all improvident debtors resort to bankruptcy. *Id.* Further, any defense recognized in other areas of the law is applicable in bankruptcy. *Id.*

<sup>67</sup>*Id.*

<sup>68</sup>*Id.*

<sup>69</sup>*Id.* at 20.

<sup>70</sup>*Id.*

reason, Countryman believed that debtors and their other creditors should be able to recover, from the improvident creditor, any damages that they can prove.<sup>71</sup> Whether as a defense or a basis for affirmative relief, Countryman believed strongly that improvident extension of credit should not remain mere common law, but must be recognized through legislation.<sup>72</sup>

#### IV. THE CURRENT STATE OF IMPROVIDENT EXTENSION OF CREDIT

Vern Countryman was never able to see improvident extension of credit codified during his lifetime.<sup>73</sup> To date, the UCCC is the most successful codification that has been achieved in the area of improvident extension of credit.<sup>74</sup> The proposals for codification slowed after the 1970s, and no solution was ever reached, although many scholars still shared Countryman's concerns.<sup>75</sup> However, in the 1980s, the financial services market began to change with the securitization of loans<sup>76</sup> and the repeal of usury laws,<sup>77</sup> and improvident extension of credit lessened as a concern.

##### A. Market Securitization

Securitization changed the financial services market because it allowed more capital to be generated while reducing risks and costs through diversification.<sup>78</sup> Securitization of both government sponsored entities and the private sector began in the 1980s.<sup>79</sup> Securitization is a multi-step process used to convert packages of loans into securities that are backed by collateral.<sup>80</sup> First, lenders make loans to borrowers.<sup>81</sup> The loans are then bundled and transferred to a special-purpose vehicle

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<sup>71</sup>*Id.*

<sup>72</sup>*Id.* at 21.

<sup>73</sup>Countryman died at the age of 81 on May 2, 1999. *HLS' Vern Countryman Dies*, *supra* note 2.

<sup>74</sup>Howard, *supra* note 2, at 297.

<sup>75</sup>Elizabeth Warren, Countryman's successor at Harvard Law School, and coauthors Teresa Sullivan and Jay Westbrook have written two books that address improvident extension of credit indirectly by describing the role that lenders play in the bankruptcies of their debtors. In the first book, the authors posit that creditors could reduce bankruptcy losses by gathering more complete information about prospective borrowers. *TERESA SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* (1989). The second book, which focuses on credit card issuers, discusses how lending practices help create the financial jeopardy that leads to bankruptcy. *TERESA SULLIVAN ET AL., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* (2000).

<sup>76</sup>Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 *TEX. L. REV.* 1255, 1273 (2002).

<sup>77</sup>Jorge Amador, *Are Credit Interest Rates Too High?*, *THE FREEMAN* (Jan. 1988), available at [www.libertyhaven.com/theoreticalorphilosophicalissues/economics/financialmarkets/creditcard.html](http://www.libertyhaven.com/theoreticalorphilosophicalissues/economics/financialmarkets/creditcard.html).

<sup>78</sup>Engel, *supra* note 76, at 1274.

<sup>79</sup>*Id.* at 1273.

<sup>80</sup>*Id.* at 1274.

<sup>81</sup>*Id.*

that reduces the risk of default associated with the loans by adding credit enhancements.<sup>82</sup> The special-purpose vehicle creates, issues, and then sells the securities to investors.<sup>83</sup> The special-purpose vehicle may collect loan payments and distribute the proceeds, or the seller of the loan may retain these rights.<sup>84</sup> Securitization eliminates the liquidity restraints suffered by banks and lenders and also allows more funds to be available to lend by creating a constant flow of money into the market.<sup>85</sup> Moreover, securitization allows more entities to join the financial services market. With securitization, lenders do not have to be large, highly capitalized financial institutions.<sup>86</sup>

*B. The Repeal of Usury Laws and the Impact of Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*<sup>87</sup>

1. The History of the Credit Card Industry

To analyze the effect of the repeal of usury laws on improvident extension of credit, it is helpful to examine the history of the credit card industry. Charge cards, the predecessors to the modern credit card, were established by Western Union and various department stores, hotels, and oil companies around 1914.<sup>88</sup> Early charge cards could be used to purchase the issuers' goods and services only, and balances had to be paid monthly.<sup>89</sup> The first general purpose card was introduced in 1950 by Diners Club and allowed customers to use the card at a variety of establishments.<sup>90</sup> In 1958, American Express issued a similar card.<sup>91</sup> The transformation from charge card to credit card occurred when banks entered the industry, issuing general purpose credit cards that allowed balances to be carried from month to month unlike the charge card.<sup>92</sup>

Bank of America issued the nation's first general purpose credit card in 1958 when it mass-mailed sixty thousand credit cards to the residents of Fresno, California.<sup>93</sup> The bank hoped to attract customers with a new revolving credit line

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<sup>82</sup>*Id.*

<sup>83</sup>*Id.*

<sup>84</sup>*Id.*

<sup>85</sup>*Id.*

<sup>86</sup>*Id.*

<sup>87</sup>439 U.S. 299 (1978).

<sup>88</sup>David A. Lander, "It 'is' the Best of Times, It 'is' the Worst of Times": A Short Essay on Consumer Bankruptcy After the Revolution, 78 AM. BANKR. L.J. 201, 204 (2004).

<sup>89</sup>*Id.*

<sup>90</sup>*Id.*

<sup>91</sup>*Id.*

<sup>92</sup>*Id.*

<sup>93</sup>*Frontline: The Secret History of the Credit Card* (PBS television broadcast Nov. 23, 2004), available at [www.pbs.org/wgbh/pages/frontline/shows/credit](http://www.pbs.org/wgbh/pages/frontline/shows/credit) [hereinafter PBS Show].

and to tap into the “pent-up consumer demands of World War II baby boomers.”<sup>94</sup> Many banks followed the example of Bank of America and began soliciting the masses with open-ended lines of credit.<sup>95</sup> However, the concept of far-off banks extending unlimited credit did not catch on immediately.<sup>96</sup> In fact, growth in the industry stalled for over a decade because most merchants only accepted credit cards issued by local banks.<sup>97</sup>

Again showing its innovation in the industry, Bank of America introduced the modern credit card in 1966 when it began licensing the BankAmericard credit card logo to other banks, providing the infrastructure for a national system to process credit card transactions.<sup>98</sup> The group of participating banks is known today as Visa.<sup>99</sup> Another similar group of banks formed the MasterCard association.<sup>100</sup> While Visa and MasterCard were able to convince merchants nationwide to accept their cards, problems for the credit card industry were just beginning.<sup>101</sup>

The next stumbling block for the industry came just before Christmas in 1966 and was termed “The Chicago Debacle.”<sup>102</sup> A group of Midwestern banks mass-mailed five million credit cards to reach the market of Chicago holiday shoppers.<sup>103</sup> Cards were mailed to convicted felons, children, and even family pets.<sup>104</sup> There was an uproar among consumers, and the nightly news reported incidents of corrupt postal workers stealing cards for organized crime rings.<sup>105</sup> Consumers were being billed for thousands of dollars of charges on credit cards that they had never received.<sup>106</sup> Congress held hearings after some consumers called for credit cards to be banned completely.<sup>107</sup> Eventually, the waters calmed for the surviving issuing banks, but not for long.

Another problem for the credit card industry came in the form of state usury laws. Originally developed in the colonial period, states established usury laws to

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<sup>94</sup>*Id.* “‘What is this with people wanting credit?’ ” Walter Wriston, the chairman of Citibank, recalled being asked by his boss. *Id.* “‘And I said, ‘Look, we just put five years of our life in a brown suit carrying an M1 rifle, and we want the refrigerator now.’” *Id.*

<sup>95</sup>*Id.*

<sup>96</sup>*Id.* Wriston explained in an interview that his hometown of 30,000 people had one bank, and “the old guy with a green eyeshade gave you credit or he didn’t.” *Id.*

<sup>97</sup>Lander, *supra* note 88, at 204.

<sup>98</sup>*Id.*

<sup>99</sup>*Id.*

<sup>100</sup>*Id.*

<sup>101</sup>*Id.*

<sup>102</sup>PBS Show, *supra* note 93.

<sup>103</sup>*Id.*

<sup>104</sup>*Id.*

<sup>105</sup>*Id.*

<sup>106</sup>*Id.*

<sup>107</sup>*Id.*

cap interest rates.<sup>108</sup> In the 1970s, inflation rates were high, and credit card companies were being squeezed between the interest rates that they could charge under the state usury laws and the high interest rates that they had to pay due to inflation.<sup>109</sup> Companies were lending money at rates much lower than they were paying out.<sup>110</sup>

## 2. *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*

In 1978, a solution came for credit card companies in the form of a Supreme Court opinion; the Court changed the interpretation of usury laws in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*<sup>111</sup> In this case, the Marquette National Bank of Minneapolis (“Marquette”), a Minnesota-chartered national banking association enrolled in the BankAmericard plan, brought an action to enjoin the operation of the First National Bank of Omaha (“Omaha”), a Nebraska-chartered national banking association also enrolled in the BankAmericard plan, until Omaha complied with the Minnesota usury laws.<sup>112</sup> Omaha solicited customers in Minnesota, among other states, and charged cardholders the interest rate mandated by Nebraska usury laws, a higher interest rate than permitted by Minnesota usury laws.<sup>113</sup> Marquette claimed to be losing customers to Omaha due to the low interest rate that they were forced to follow.<sup>114</sup> The Solicitor General of Minnesota joined the lawsuit, arguing that the exportation of Nebraska’s interest rate would make it difficult for states to enact effective usury laws.<sup>115</sup>

The Supreme Court held that § 85 of the National Bank Act of 1864<sup>116</sup> allowed Omaha to charge its Minnesota customers a higher interest rate than that sanctioned

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<sup>108</sup>Amador, *supra* note 77. States had the power to establish their own usury rates so they often varied from state to state. *Id.* In the 1950s, one state had a rate of 4%, five states had a rate of 5%, forty states had a rate of 6%, and four states had a rate of 7%. *Id.* (quoting SIDNEY HOMER, A HISTORY OF INTEREST RATES 401 (1977)).

<sup>109</sup>PBS Show, *supra* note 93.

<sup>110</sup>*Id.* Walter Wriston from Citibank explained that “[y]ou are lending money at 12% and paying 20%. *Id.* You don’t have to be Einstein to realize you’re out of business.” *Id.*

<sup>111</sup>439 U.S. at 299.

<sup>112</sup>*Id.* at 301.

<sup>113</sup>*Id.* at 302. Nebraska law permitted Omaha to charge an interest rate of 18% per year on the first \$999.99 and 12% per year on amounts of \$1,000 and more. *Id.* Minnesota law fixed the permitted annual interest rate at 12%. *Id.*

<sup>114</sup>*Id.* at 304.

<sup>115</sup>*Id.* at 316, 318-19.

<sup>116</sup>12 USC § 85 (2000). Section 85 of the Act, titled “Rate of interest on loans, discounts and purchases,” states:

Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so



by Minnesota law.<sup>117</sup> The Court reasoned that Omaha could not be deprived of its Nebraska location merely because the BankAmericard program extended credit to residents of other states; Nebraska was the state from which credit was extended, unpaid balance finance charges were assessed, payments were received, and credit cards were issued.<sup>118</sup> Further, the statutory location of the bank did not change just because the credit cards could be used to purchase goods and services outside of Nebraska.<sup>119</sup> However, the Court agreed with the Solicitor General of Minnesota that the exportation of interest rates may impair the ability of states to maintain effective usury laws but indicated that this problem was always a part of the National Bank Act and that any correction should be achieved legislatively.<sup>120</sup>

The *Marquette* decision applied to all types of consumer loans but had its greatest impact on the credit card industry.<sup>121</sup> Due to the ability of credit card lending to be accomplished completely by mail, credit card companies could move their headquarters to the states with the most liberal usury laws.<sup>122</sup> Citibank was the first bank to seize the opportunity presented by the *Marquette* decision.<sup>123</sup> By 1980, Citibank, incorporated in New York, had lost more than one billion dollars because the inflation rate exceeded the amount of interest that the company could charge its credit card customers under the New York usury laws.<sup>124</sup> Walter Wriston, the

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limited shall be allowed for associations organized or existing in any such State under this title. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the States of the United States and the District of Columbia shall be at the rate allowed by the laws of the county, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight-drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.

*Id.*

<sup>117</sup>*Marquette*, 439 U.S. at 307-19. The District Court entered partial summary judgment for *Marquette*, holding that the Minnesota usury law was not preempted by § 85 of the National Bank Act. *Id.* The Supreme Court of Minnesota reversed, holding that Nebraska usury laws governed the operation of the Nebraska national bank's credit card program. *Id.* The United States Supreme Court affirmed the decision of the Supreme Court of Minnesota. *Id.* at 306.

<sup>118</sup>*Id.* at 310-12.

<sup>119</sup>*Id.* at 312-13.

<sup>120</sup>*Id.* at 318-19.

<sup>121</sup>Lander, *supra* note 88, at 214.

<sup>122</sup>*Id.*

<sup>123</sup>PBS Show, *supra* note 93.

<sup>124</sup>*Id.*

chairman of Citibank, attempted to convince New York legislators to raise the usury rates or to eliminate them all together, but the legislators refused.<sup>125</sup> At the same time, South Dakota was considering eliminating its usury laws in an attempt to stimulate the local economy.<sup>126</sup> Wriston contacted Bill Janklow, the governor of South Dakota, to make a deal.<sup>127</sup> He proposed that if South Dakota would quickly pass legislation that would enable Citibank to move its credit card operations to the state, the bank would bring four hundred high-paying, white-collar jobs.<sup>128</sup> Other banks began to follow the lead of Citibank and move to South Dakota.<sup>129</sup> Other states caught on as well; Delaware passed similar legislation the following year, and many other states loosened their usury laws.<sup>130</sup>

During the years prior to the *Marquette* decision when credit card companies were losing billions of dollars, some consumers also paid the price for state usury laws.<sup>131</sup> Eligibility standards for new applicants became more stringent, and some banks refused new accounts altogether.<sup>132</sup> Moreover, millions of delinquent accounts were discontinued.<sup>133</sup> Once states began to change interest rates, profits soared for the credit card industry, and consumers could easily obtain credit cards.<sup>134</sup> Between 1980 and 1990, the number of credit cards more than doubled, and the average household credit card balance rose from \$518 to \$2,700.<sup>135</sup> With their new profits and power, credit card companies were given more freedom while consumer protections, such as improvident extension of credit, began to relax.<sup>136</sup>

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<sup>125</sup>*Id.* In an interview, Wriston said that he told New York's political leaders that they only had to raise the usury ceiling a reasonable amount, and Citibank would stay in the state. *Id.* Legislators did not believe that the company would actually relocate, so they did not reconsider the interest rates. *Id.*

<sup>126</sup>*Id.* Bill Janklow, the former governor of South Dakota, said that "[the state] was in the poor house. It cost 42 cents to a bushel in 1980 to haul wheat. *Id.* When something's only selling for \$2.20 a bushel, you certainly can't afford to be paying almost 50 cents a bushel to ship it." *Id.*

<sup>127</sup>*Id.*

<sup>128</sup>*Id.* Wriston also agreed that Citibank would be a limited bank, as not to create competition for existing local banks. *Id.* Wriston told Janklow, "We'll put the facility in an inconvenient place for customers and we'll pay different interest rates. All we want to do is use it to issue cards." *Id.* As for the legislation, it was actually drafted by Citibank, and it was introduced and passed by the legislature in one day. *Id.*

<sup>129</sup>*Id.* Ultimately, 3000 new high-paying jobs were brought to South Dakota. *Id.*

<sup>130</sup>*Id.*

<sup>131</sup>Amador, *supra* note 77.

<sup>132</sup>*Id.*

<sup>133</sup>*Id.*

<sup>134</sup>PBS Show, *supra* note 93.

<sup>135</sup>*Id.*

<sup>136</sup>*Id.*

## V. A GREATER NEED FOR CONSUMER PROTECTION

A. *New Tools for the Industry*

## 1. Annual Fees

Following the explosion of credit cards after the elimination of state usury laws, the credit card industry continued to evolve and began to find new ways to take advantage of consumers. In 1980, the annual fee was introduced without much protest from cardholders.<sup>137</sup> President Carter attempted to slow inflation by imposing a freeze on soliciting new credit card accounts.<sup>138</sup> The freeze only lasted a few months, but it was long enough to introduce the twenty dollar annual fee to counteract “transactors,” the unprofitable customers who paid off their balances each month.<sup>139</sup> The annual fee allowed these customers to be profitable as well.<sup>140</sup> For ten years, the industry profited from the annual fee, but AT&T began offering a credit card with no annual fee in 1990.<sup>141</sup> The response from consumers was enormous, and some competitors also eliminated their annual fees.<sup>142</sup> But the days of the straight forward interest rates and mass-marketed credit cards were numbered.<sup>143</sup>

## 2. Complex Contract Terms

Credit cards became complex financial arrangements for customers.<sup>144</sup> The terms and rates were often changed by the credit card companies and were too complex to be understood by the cardholders.<sup>145</sup> Like the addition of annual fees, the change followed an action by the President of the United States.<sup>146</sup> On November 12, 1991, President George Bush announced that the economy and consumer confidence could be stimulated by lowering credit card rates.<sup>147</sup> The Senate introduced a national cap

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<sup>137</sup>*Id.*

<sup>138</sup>*Id.*

<sup>139</sup>*Id.*

<sup>140</sup>*Id.*

<sup>141</sup>*Id.*

<sup>142</sup>*Id.* AT&T received 260,000 phone calls from interested consumers on the first day that the no annual fee credit card was introduced. *Id.*

<sup>143</sup>*Id.*

<sup>144</sup>*Id.*

<sup>145</sup>*Id.*

<sup>146</sup>*Id.*

<sup>147</sup>*Id.* The announcement occurred at a \$1,000-a-plate fundraising luncheon for President Bush in New York. *Id.* An aide made a last minute addition to the President’s speech. *Id.* The President announced, “I’d frankly like to see credit cards [sic] rates down. I believe that would help stimulate the consumer and get consumer confidence moving again.” *Id.* With two sentences, credit cards were forever changed. *Id.*

to credit card interest rates equaling 14% the very next day.<sup>148</sup> After only thirty minutes of debate, the Senate approved the bill by a vote of 74-19.<sup>149</sup> By the week's end, the credit card industry was in a panic, and the stock market plunged.<sup>150</sup> The concept of a national credit card rate cap died out, but the industry refers to the incident as "the Big Scare."<sup>151</sup> Following "the Big Scare," the credit card industry decided that it was time to reevaluate its pricing practices.<sup>152</sup>

### 3. Higher Credit Lines and Penalty Fees

The industry began searching for more profitable pricing methods, and Andrew S. Kahr<sup>153</sup> was one of the first in the industry to discover that it was possible to analyze customer financial data with complex formulas and scoring systems to predict which customers were profitable "revolvers," those least likely to pay off their credit card balances each month.<sup>154</sup> Kahr also determined that higher credit lines were both attractive to customers and highly profitable for credit card companies.<sup>155</sup> Companies could raise credit lines by decreasing the required minimum payment.<sup>156</sup> Heightened credit lines increased profits for credit card companies in two ways.<sup>157</sup> First, each dollar of principal would generate more interest because it would take longer to pay off balances.<sup>158</sup> Second, the principal itself would increase because cardholders could take on more debt and make the same minimum monthly payments.<sup>159</sup> Critics say that the lower minimum payment percentage shrouds the true cost of debt and keeps consumers dangerously leveraged.<sup>160</sup> In addition, the credit card companies implemented penalty fees to

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<sup>148</sup>*Id.* The following day, after the President's speech, Senator Alfonse M. D'Amato introduced the bill. *Id.* The Senator, representing the state of New York, had attended the luncheon. *Id.*

<sup>149</sup>*Id.*

<sup>150</sup>*Id.*

<sup>151</sup>*Id.*

<sup>152</sup>*Id.*

<sup>153</sup>*Id.* Kahr was a child prodigy who earned a Ph.D. in mathematics from MIT when he was twenty years old. *Id.* He became a financial industry consultant and founded a credit card company in 1984 that would become Provident, one of the top ten credit card issuers. *Id.*

<sup>154</sup>*Id.*

<sup>155</sup>*Id.*

<sup>156</sup>*Id.* For example, if minimum payments were cut from 5% to 2%, a company could increase a credit line from \$2,000 to \$5,000 and still charge the same \$100 minimum payment. *Id.* Today, 2% is the standard minimum payment and the average household credit card debt has tripled since 1990. *Id.*

<sup>157</sup>*Id.*

<sup>158</sup>*Id.*

<sup>159</sup>*Id.*

<sup>160</sup>*Id.*

raise profits. Penalty fees raise billions of dollars in revenue each year.<sup>161</sup> Because most consumers do not anticipate that they will make late payments, they fail to shop around for better late fees.<sup>162</sup> However, most consumers are late at one point or another.<sup>163</sup>

*B. The Legality of Penalty Fees and Smiley v. Citibank*<sup>164</sup>

As with interest rates in the *Marquette* case, the Supreme Court addressed the issue of penalty fees in *Smiley v. Citibank*.<sup>165</sup> Like *Marquette*, the *Smiley* decision rested on the interpretation of § 85 of the National Bank Act.<sup>166</sup> Barbara Smiley, a resident of California and Citibank cardholder, brought a class-action suit against Citibank, a South Dakota corporation, on behalf of herself and other California cardholders.<sup>167</sup> Smiley alleged that the penalty fees<sup>168</sup> permitted under South Dakota law violated statutory and common law of California.<sup>169</sup> Relying on the *Marquette* decision, the Supreme Court held that § 85 of the National Bank Act permitted a national bank to charge its loan customers interest at the rate allowed by the laws of the state in which the bank is located.<sup>170</sup>

Smiley also challenged the definition of interest.<sup>171</sup> The Court deferred to the definition provided by the Comptroller of the Currency.<sup>172</sup> The Comptroller said that

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<sup>161</sup>*Id.*

<sup>162</sup>*Id.*

<sup>163</sup>*Id.* The average prime consumer incurs one late fee a year. *Id.* The average sub-prime consumer incurs two and a half late fees per year. *Id.*

<sup>164</sup>517 U.S. 735 (1996).

<sup>165</sup>*Id.*

<sup>166</sup>*Id.* at 737.

<sup>167</sup>*Id.* at 738.

<sup>168</sup>*Id.* Petitioner held two credit cards from Citibank, a Classic Card and a Preferred Card. *Id.* The Classic Card agreement allowed Citibank to charge a late fee of \$15 for each monthly period in which the cardholder failed to make the minimum monthly payment within twenty-five days of the due date. *Id.* The Preferred Card agreement permitted Citibank to charge a late fee of \$6 if the minimum payment was not received within fifteen days of the due date and an additional fee of \$15 or 0.65% of the outstanding balance, whichever is greater, if the minimum payment was not received by the next minimum monthly payment due date. *Id.*

<sup>169</sup>*Id.* Smiley alleged the following common law violations: breach of duty of good faith and fair dealing, unjust enrichment, fraud and deceit, negligent misrepresentation, and breach of contract. *Id.* She alleged the following statutory claims: CAL. BUS. & PROF. CODE ANN. § 17200 (West Supp. 1996) (prohibiting unlawful business practices) and CAL. CIV. CODE ANN. § 1671 (West 1985) (invalidating unreasonable liquidated damages). *Smiley*, 517 U.S. at 738 n.1.

<sup>170</sup>*Id.* at 737.

<sup>171</sup>*Id.* at 740.

<sup>172</sup>*Id.* The Court deferred to the Comptroller of the Currency because it is the practice of the Court to defer to reasonable judgments of agencies in regard to the meaning of ambiguous terms in statutes that they administer. *Id.* at 739 (citing *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)). The Comptroller of the Currency is charged with

the term “interest,” as used in the National Bank Act, includes any payment of compensation to a creditor or prospective creditor for an extension of credit, any making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended, such as numerical periodic rates, late fees, not sufficient funds (NSF) fees, over-limit fees, annual fees, cash advance fees, and membership fees.<sup>173</sup> However, the term does not ordinarily include appraisal fees, premiums, and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders’ fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.<sup>174</sup> Ultimately, the Court validated the penalty fees charged to cardholders and decided that Citibank could charge penalty fees at any rate permitted by the laws of the state in which it is located.<sup>175</sup>

The *Smiley* decision hurt consumers. Even Duncan A. MacDonald, the former general counsel of Citibank’s credit card division who spearheaded the case, has admitted that penalty fees are out of control and that they are unfair to consumers.<sup>176</sup> MacDonald said that at the time of the *Smiley* decision, the company’s attorneys felt that they were working for a good cause—free-market pricing.<sup>177</sup> Late fees were common and ranged from \$5 to \$15 before the Supreme Court decision, but after the decision, late fees soared to almost \$40.<sup>178</sup> MacDonald was quoted as saying, “I certainly didn’t imagine that someday we might’ve ended up creating Frankenstein.”<sup>179</sup> Mr. Kahr, on the other hand, argues that the market will decide what is fair for consumers.<sup>180</sup>

## VI. INADEQUATE SOLUTIONS

Many people feel that solutions to the problem of improvident extension of credit already exist in the form of market self-regulation, educational programs, and the unconscionability doctrine. However, these solutions do not adequately protect consumers from being exploited by improvident creditors.

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the enforcement of banking laws. *Id.* (citing *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995)).

<sup>173</sup>*Id.* at 739-40.

<sup>174</sup>*Id.* at 740.

<sup>175</sup>*Id.* at 735.

<sup>176</sup>PBS Show, *supra* note 93. MacDonald said, “Millions and millions of people are being excessively charged late fees and bad-check fees and over-the-limit fees and then these 25% APRs to make profits for the industry, so that they can keep the rates lower for people who are rate sensitive, who can in fact, shop the system.” *Id.*

<sup>177</sup>*Id.*

<sup>178</sup>*Id.*

<sup>179</sup>*Id.*

<sup>180</sup>*Id.* Kahr said that, “[i]f someone is riskier, he should be paying a higher rate. It’s more economically sound. It’s fairer for riskier people to pay a higher interest rate, higher fees, whatever it is, than less risky people.” *Id.*

*A. Market Self-Regulation*

Some economists believe that the market will correct its own problems through market competition and lower interest rates.<sup>181</sup> Several banks have already voluntarily lowered their interest rates.<sup>182</sup> For example, American Express created the Optima credit card with a 13.5% interest rate.<sup>183</sup> American Express claims that the market is working and “will and does respond to consumer dissatisfaction by reducing interest rates.”<sup>184</sup> Financial newspapers around the country have applauded American Express for their actions.<sup>185</sup> However, the Optima card is not available for everyone—only those consumers who already hold American Express cards can apply for Optima cards.<sup>186</sup> Plus, there is an additional \$15 fee on top of the \$45 annual charge.<sup>187</sup> Applicants must also meet more stringent requirements for the lower rate card; the card is only offered to those viewed as safe credit risks with solid credit histories who have been American Express members for over a year.<sup>188</sup> The new low rate credit cards have provided no protection for the low income cardholders who are typically the victims of improvident extension of credit.<sup>189</sup> Nor have the lower rate cards created a credit card war as predicted by economists.<sup>190</sup> Instead, the lower rate credit cards have created a segmentation in the market.<sup>191</sup> Lower credit risks can borrow at lower rates, and higher risk consumers must borrow at higher rates, further disserving those who need the most protection.<sup>192</sup>

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<sup>181</sup>Amador, *supra* note 77.

<sup>182</sup>*Id.* Besides American Express, Citicorp has also cut rates for preferred customers. *Id.* Most cardholders have an interest rate of 19.8%, while preferred customers have a rate of 16.8%. *Id.* Similarly, Wells Fargo decreased rates from 20% to 17% for customers who had a Wells Fargo card for at least five years. *Id.*

<sup>183</sup>*Id.*

<sup>184</sup>*Id.*

<sup>185</sup>*Id.* *The Wall Street Journal* stated that “[t]he greater consumer sensitivity to interest rates no doubt figured into Amex’s plans to take a plunge into the business with a lower-rate card . . . . Credit card interest almost certainly will come down. It will come down without rate ceilings. Nothing does it like competition.” *Id.* (quoting Editorial, *Pressure on Plastic*, WALL ST. J., Mar. 16, 1987, at 22.). This has been termed the Credit Card War. *Id.*

<sup>186</sup>*Id.*

<sup>187</sup>*Id.*

<sup>188</sup>*Id.*

<sup>189</sup>*Id.*

<sup>190</sup>*Id.*

<sup>191</sup>*Id.* *Fortune* predicted that the market would see “small interest rate reductions on premium cards—those offering larger credit lines and requiring better credit histories.” *Id.*

<sup>192</sup>*Id.*

*B. Credit Counseling and Educational Programs*

Credit counseling and financial education programs are also suggested solutions to the problem of improvident extension of credit.<sup>193</sup> These programs have been around for thirty years and have “helped” millions of people.<sup>194</sup> The programs purport to teach consumers to save money and to create a reserve for emergencies.<sup>195</sup> However, the success of these programs is questionable at best.<sup>196</sup> Low quality providers impose excessive charges and provide poor services.<sup>197</sup> Higher quality organizations do provide an education on finances and credit.<sup>198</sup> It is easy to teach someone that saving is important; however, it is difficult, if not impossible, for consumers with little disposable income to save money when they can barely provide for their families. Moreover, the success of these programs is often measured by the number of people not filing a bankruptcy petition within a specified period of time after a counseling session.<sup>199</sup> To measure the value of these programs, the success must be evaluated over a long-term period of time or by another method of assessment.<sup>200</sup>

*C. Unconscionability*

Unconscionability, while possibly encompassing the idea of improvident extension of credit, is also an inadequate solution. To become an adequate solution, courts must extend unconscionability a step further to improvident extension of credit. Because unconscionability has no formal definition, courts apply this doctrine in different ways. As previously discussed in Part II, many courts look at the bargaining position of the parties and an absence of meaningful choice.<sup>201</sup> Improvident credit agreements may satisfy this definition, but unconscionability does not take into consideration the knowledge of the debtors’ financial position and their inability to pay. As developed for consumer protection, unconscionability is difficult and costly to invoke because it requires a lawyer’s expertise and, therefore, is not readily available to consumers. Furthermore, statutory unconscionability as defined by the UCC only applies to transactions of goods; thus, credit card transactions lie outside of its scope.<sup>202</sup>

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<sup>193</sup>Lander, *supra* note 88, at 211.

<sup>194</sup>*Id.*

<sup>195</sup>*Id.* at 212.

<sup>196</sup>*Id.*

<sup>197</sup>*Id.* at 217.

<sup>198</sup>*Id.* at 211.

<sup>199</sup>*Id.* at 212.

<sup>200</sup>*Id.*

<sup>201</sup>*See, e.g.,* Toker v. Westerman, 274 A.2d 78 (N.J. Dist. Ct. Union County 1970); Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

<sup>202</sup>U.C.C. § 2-302 (2004).



VII. A MOVE IN THE RIGHT DIRECTION: *DISCOVER BANK V. OWENS*

In 2003, one municipal court judge stood up for an impoverished woman against a giant in the credit card industry.<sup>203</sup>

A. *Facts*

Ruth M. Owens was one of several thousand Clevelanders each year who become the subjects of credit card collection suits as a result of ballooning credit card debt.<sup>204</sup> Debtors cite many reasons for being overwhelmed by the accumulated credit card debt: disability, declining real wages, job displacement, and rising health care costs.<sup>205</sup> Owens was no exception.<sup>206</sup>

Discover Bank (“Discover”), a lender and issuer of credit cards, filed a breach of contract claim against Owens, a Discover Card holder, for failure to make the minimum monthly payments required under the cardholder agreement.<sup>207</sup> Discover claimed that Owens owed a balance of \$5,564.28.<sup>208</sup> In response to the plaintiff’s complaint, Owens filed a handwritten answer on her own behalf, stating:

I would like to inform you that I have no money to make payments. I am on Social Security Disability. After paying my monthly utilities, there is no money left except little food money and sometimes it isn’t enough. If my situation was different I would pay. I just don’t have it. I’m sorry.<sup>209</sup>

At trial, Discover provided the court with a copy of Owens’ Cardmember Agreement, which outlined the minimum monthly payment requirement, the periodic finance charges, and the various fees that were applicable, as well as a copy of Owens’ monthly statements from January 1996 to May 2003.<sup>210</sup> The statements showed that Owens had a credit limit of \$1,900 and had stopped using the card in March of 1997 before she exceeded her limit.<sup>211</sup> Owens asserted that she had made her best effort to pay under her financial circumstances and had in fact made many payments, totaling \$3,492, over the six years that followed.<sup>212</sup> Due to miscellaneous fees and finance charges, Owens had paid \$3,492 on a debt of \$1,900, yet still carried a balance of \$5,564.28.<sup>213</sup>

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<sup>203</sup>Discover Bank v. Owens, 822 N.E.2d 869 (Ohio Mun. Ct. Clev. 2004).

<sup>204</sup>*Id.* at 871.

<sup>205</sup>*Id.*

<sup>206</sup>*Id.*

<sup>207</sup>*Id.*

<sup>208</sup>*Id.*

<sup>209</sup>*Id.*

<sup>210</sup>*Id.*

<sup>211</sup>*Id.* at 872.

<sup>212</sup>*Id.*

<sup>213</sup>*Id.* Along with late fees and over-limit fees, Owens was charged monthly for a Discover card product called CreditSafe Plus which would suspend her payments and finance charges without affecting her credit rating if she became unemployed, hospitalized, or

Judge Triozzi questioned how something like this could happen and noted that if Owens had stopped paying on her account in 1997, as an “unscrupulous person” may have done, her account would have been closed.<sup>214</sup> Discover would have filed an action seven years earlier for an amount not in excess of \$2,000.<sup>215</sup> Discover may even have agreed to negotiate a settlement at a fraction of the amount due, as credit card companies often do.<sup>216</sup> However, Owens was “not unscrupulous,” and she tried to repay her debt on her meager Social Security Disability income until she realized that “it was a debt out from under which she could never climb.”<sup>217</sup> The court acknowledged the “widespread financial exploitation of the urban poor by overbearing credit card companies” and found in favor of Ruth Owens.<sup>218</sup>

#### B. Court's Rationale

The court relied on the notion of equity to decide this case. “The function of equity is to supplement the law where it is insufficient, moderating the unjust results that would follow from the unbending application of the law.”<sup>219</sup> The court determined that Owens had no remedy at law; thus, the court’s use of its equitable jurisdiction was both proper and necessary.<sup>220</sup> No remedy exists at law because, as previously discussed, improvident extension of credit has ever been codified.

In the opinion, Judge Triozzi discussed several doctrines in equity while balancing the responsibility of each party.<sup>221</sup> Together, these doctrines closely resemble the theory of improvident extension of credit.<sup>222</sup> The court first discussed Owens’s own responsibility for her situation; no one forced her to open the credit card, nor did they force her to use it.<sup>223</sup> Moreover, she could have sought legal or financial counsel several years earlier to determine the best option for her.<sup>224</sup> Instead, Owens decided to continue trying to pay her debt; “[w]hile clearly placing her on the moral high road, that same highway unfortunately was her road to financial

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disabled. *Id.* Judge Triozzi presumed that since Owens was already on Social Security Disability and was already unemployed, CreditSafe Plus only pertained to the possibility of Owens becoming hospitalized. *Id.* at 871.

<sup>214</sup>*Id.* at 872.

<sup>215</sup>*Id.*

<sup>216</sup>*Id.*

<sup>217</sup>*Id.* at 872-73.

<sup>218</sup>*Id.* at 875.

<sup>219</sup>*Id.* at 874. (citing *Salem Iron Co. v. Hyland*, 77 N.E.751 (Ohio 1906)).

<sup>220</sup>*Id.* The Cleveland Municipal Court has the authority “to hear and determine all legal and equitable remedies necessary or proper for a complete determination of the rights of the parties.” *Id.*

<sup>221</sup>*Id.* at 873-74.

<sup>222</sup>*Id.* at 873.

<sup>223</sup>*Id.*

<sup>224</sup>*Id.*

ruin.”<sup>225</sup> The court stated that it is unfair for someone who “wants to do right to end up so worse off.”<sup>226</sup>

Next, the court looked at the responsibility of the creditor, encompassing the theory of improvident extension of credit.<sup>227</sup> Simply stated, improvident extension of credit is when a creditor knows that a debtor has financial problems and will be unable to repay the debt but extends credit nonetheless. Much of the rationale from *Discover Bank* expresses this idea. For example, the court said that it was “unfair for a creditor to extend easy credit at stiff terms to someone who clearly was in a difficult financial predicament.”<sup>228</sup> Further, “Discover kept Owens’s account open and active long after it was painfully obvious that she was never going to be able to make payments at the expected level.”<sup>229</sup> A contract may be equally unenforceable when a creditor leaves a debtor with little disposable income and presses a demand for judgment despite being aware of the debtor’s dire financial straits.<sup>230</sup> Moreover, the court also cited an injured party’s duty to mitigate damages to prevent forfeiture of those that the party could have reasonably avoided.<sup>231</sup>

Judge Triozzi also applied the doctrine of unjust enrichment in this case.<sup>232</sup> Due to the fact that Discover failed to “even minimally pay attention to Owens’s circumstances, and for allowing the debt to accumulate unchecked,” the court determined that a favorable verdict for the plaintiff would create unjust enrichment; such a verdict would allow Discover to retain money that, in justice and in equity, belonged to Ruth Owens.<sup>233</sup>

Finally, the court determined that the agreement between the parties was unconscionable as it applied to Owens.<sup>234</sup> Using the definition of unconscionability espoused in *Williams*, the court found that there was an absence of meaningful choice on the part of Owens and contract terms that were unreasonably favorable to Discover.<sup>235</sup>

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<sup>225</sup>*Id.*

<sup>226</sup>*Id.*

<sup>227</sup>*Id.*

<sup>228</sup>*Id.*

<sup>229</sup>*Id.*

<sup>230</sup>*Id.* (citing *City Fin. Serv. v. Smith*, No.97 CVF 00679, 2000 WL 288469 (Ohio Mun. Ct. Clev. Jan. 4, 2000)).

<sup>231</sup>*Id.* (citing *S&D Mech. Constrs., Inc. v. Enting Water Conditioning Sys., Inc.*, 593 N.E.2d 354 (Ohio Ct. App. 1991); *Geis v. Zylka*, 650 N.E.2d 211 (Ohio Mun. Ct. Clev. 1995)).

<sup>232</sup>*Id.*

<sup>233</sup>*Id.* (citing *Hummel v. Hummel*, 14 N.E.2d 923 (Ohio 1938); *Seward v. Mentrup*, 622 N.E.2d 756 (Ohio Ct. App. 1993)).

<sup>234</sup>*Id.* at 874.

<sup>235</sup>*Id.* 873-74 (citing *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965)).

The court used several general theories to arrive at what it thought was a fair result. Instead, it could have used the theory of improvident extension of credit to arrive at the same conclusion.

### C. City Financial Services v. Smith

*Discover Bank* did not mention “improvident extension of credit,” but the court cited a case that did: *City Financial Services v. Smith*.<sup>236</sup> In this case, Laura Smith took out a loan from City Financial Services (“City Financial”) in the amount of \$3,000, plus \$104.01 for single credit life insurance and \$365.40 for property insurance, for a total of \$3,619.69.<sup>237</sup> The interest rate on the loan was 22.5%.<sup>238</sup> After Smith received the money, her ex-husband stole it in a fraud scheme.<sup>239</sup> Smith was left holding the debt through no fault of her own.<sup>240</sup> Her ex-husband was arrested and prosecuted but paid no restitution.<sup>241</sup> Smith made one payment in the amount of \$355 before going into default on the loan.<sup>242</sup> City Financial filed a breach of contract claim against her.<sup>243</sup>

The parties agreed on the facts of the case, but the defendant claimed that the entire loan transaction should be voided based on the theory of “improvident lending” because the plaintiff knew it was unreasonable to expect the defendant to be able to pay the terms of the loan given her limited disability income.<sup>244</sup> At trial, evidence showed that Smith had a prior loan with City Financial and was behind on her payments.<sup>245</sup> However, the plaintiff knew that the defendant had a residence that could secure any future payment upon which she defaulted.<sup>246</sup> The court found that the contract between the parties was unconscionable and unenforceable because the creditor left the debtor with little disposable income and pressed for a judgment despite being aware of the debtor’s unfortunate financial position.<sup>247</sup>

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<sup>236</sup>*City Fin. Serv. v. Smith*, No.97 CVF 00679, 2000 WL 288469, at \*1 (Ohio Mun. Ct. Clev. Jan. 4, 2000).

<sup>237</sup>*Id.*

<sup>238</sup>*Id.*

<sup>239</sup>*Id.* After Laura Smith’s husband, Toby Smith, took the money, she contacted the police and prosecuted him for theft. *Id.* He was convicted and given a suspended sentence. *Id.* There was no evidence that Toby Smith paid Laura Smith any restitution. *Id.* At the time of the fraud scheme, Toby Smith was married to another woman and was deceiving her and that family as well. *Id.*

<sup>240</sup>*Id.*

<sup>241</sup>*Id.*

<sup>242</sup>*Id.*

<sup>243</sup>*Id.*

<sup>244</sup>*Id.* at \*2.

<sup>245</sup>*Id.*

<sup>246</sup>*Id.*

<sup>247</sup>*Id.* Facts at trial indicated that Smith received disability income in the amount of \$574 a month and had \$355 in monthly expenses. *Id.* At the time she applied for the second loan, she also had \$6700 in debt on two credit cards. *Id.* City Financial required at least 35%

In *City Financial Services*, the court recognized the term “improvident lending” but resolved the case on other theories. The term was never mentioned in *Discover Bank*, possibly for the following reasons. Improvident extension of credit is a term generally used by Legal Aid attorneys. Most people in the legal community are unaware of this theory. In *Discover Bank*, the defendant, who was impoverished and likely could have qualified for legal assistance, was not represented by counsel of any kind but instead chose to represent herself. Therefore, the defense of improvident extension of credit was never raised on her behalf. Further, while the court in *Discover Bank* cited *City Financial Services*, it is likely that “improvident lending,” as it was termed in the case, was never fully considered in determining the outcome of *Discover Bank* because it was not actually used in deciding the outcome of *City Financial Services*.

#### VIII. POSSIBLE SOLUTIONS

The need for a solution to the problem of improvident extension of credit is clear.<sup>248</sup> Judge Triozzi is not the only person who has taken notice of this growing problem. Consumer advocates and politicians alike have expressed similar concerns. At a Congressional hearing on the issue of credit card debt, consumer advocate Elgie Holstein of the Bancard Holders of America explained that there is an economic level below which consumers should not be extended credit because it not only hinders the consumer, but the credit card company as well.<sup>249</sup> Holstein placed much of the blame on the large interstate banks and institutions that mass-market credit cards.<sup>250</sup> In comparing loss rates, Holstein stated that the banks that mass-market credit cards indiscriminately experience the highest rates of loss.<sup>251</sup>

Senator Jim Sasser agreed with Holstein that not all consumers should be advanced credit, only those who are creditworthy.<sup>252</sup> Sasser expressed the view that, under the current system, those cardholders who timely pay their bills also suffer.<sup>253</sup> People who pay their bills also pay the bills of those who do not in the form of higher interest rates.<sup>254</sup> In Sasser’s opinion, if credit was only advanced to those who

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disposable income in order to qualify for a loan. *Id.* Smith had a disposable income of only 21%. *Id.* However, City Financial calculated her disposable income to be 36%, 1% higher than that required to secure a loan, by stating her income to be \$718 a month. *Id.*

<sup>248</sup>Statistics show that nearly 40 million people a year are in enough financial trouble due to credit card debt to take drastic action. Jeanette Joy Fisher, *Some Startling Statistics About American Consumers* (December 27, 2005), [www.ezinearticles.com/?Some-Startling-Statistics-about-American-Consumers&id=118883](http://www.ezinearticles.com/?Some-Startling-Statistics-about-American-Consumers&id=118883). Almost 1.5 million people in the United States are forced to file for bankruptcy every year, and the same amount will turn to credit counseling services in an attempt to avoid bankruptcy. *Id.* The remaining 37 million debtors will attempt to work out payment plans on their own with their creditors. *Id.*

<sup>249</sup>Amador, *supra* note 77.

<sup>250</sup>*Id.*

<sup>251</sup>*Id.*

<sup>252</sup>*Id.*

<sup>253</sup>*Id.*

<sup>254</sup>*Id.*

are creditworthy, rates would be substantially lower, and the banks that advance credit could still make a reasonable profit.<sup>255</sup>

Judges in the legal system need to take notice of the opinions in both *Discover Bank* and *City Financial Services*. Courts must revive the theory of improvident extension of credit that was promoted in the past by scholars such as Vern Countryman. Consumers, especially low-income, poorly educated consumers, need to be protected from corporate giants who see cardholders as penalty fees and interest rates instead of the individuals they are—individuals struggling with financial difficulties. When verdicts come down in favor of the cardholders, the consumers will gain power in the contractual relationship, and the credit card companies will lose some of their power. The playing field will level off, and the pendulum of power will swing back toward the consumer.

However, common law may not be the strongest solution. Congress should codify improvident extension of credit to fully protect the consumer by passing a federal law under its commerce power to clearly define improvident extension of credit and establish the proper penalties. Congress has a substantial interest in uniform laws because improvident extension of credit exists in every state. A federal law may be preferred to a common law solution for several reasons. First, as of the time of this writing, no case of precedential value exists that rules in favor of the consumer victim of improvident extension of credit. Also, unlike a common law defense, a consumer could invoke a federal statute without the difficulty and expense of hiring a lawyer, thus increasing the availability of a remedy for consumers. Finally, the uniformity that could be achieved through a federal law would be hard to achieve in common law where cases are decided in different jurisdictions on a case by case basis.

Such a statute prohibiting improvident extension of credit could be short in length and narrowly construed to apply only to situations involving credit card debt while still encompassing Vern Countryman's original theory. Legislators could look to the language of previously proposed legislation, such as that discussed in Part III. For example, improvident extension of credit could be defined as having four elements with the following language:

If the court, as a matter of law, finds that a contract was based on improvident extension of credit, the court may refuse to enforce the contract. An improvident extension of credit is defined as

1. a contractual extension of credit to a debtor,
2. where it cannot be reasonably expected that the debtor can repay the debt according to the terms of the agreement,
3. in view of the circumstances of the debtor at the time that credit was extended,
4. as these circumstances were known to the creditor or would have been revealed to him on reasonable inquiry prior to credit extension.

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<sup>255</sup>*Id.*

The legislators could then decide whether to codify improvident extension of credit solely as a defense or to draft it as a basis for affirmative relief as well. As discussed in Part III, section *E*, Vern Countryman felt that improvident extension of credit should be a basis for affirmative relief because the improvident debt may have caused other damages to the debtor.<sup>256</sup> For example, the debtor may have defaulted on other debts.<sup>257</sup> For this very reason, Countryman believed that affirmative relief should also be extended to other creditors who were injured as a result of the improvident debt.<sup>258</sup>

#### IX. CONCLUSION

Improvident extension of credit must be recognized and stopped through the legal system; otherwise, society will also pay the price.<sup>259</sup> George Ritzer and Robert Manning, prominent sociologists, assert that improvident extension of credit has both micro and macro effects on society.<sup>260</sup> On the micro level, credit problems increase stress, create mental health problems, and cause family abuse because debt is the primary contributing factor to divorce and family problems.<sup>261</sup> On the macro level, society must bear the burden of broken homes, dysfunctional families, and people needing mental health services.<sup>262</sup> This leads to a need for more jails, more mental health services, more children and mothers needing shelter from abuse, more rehabilitative services, and more taxes to pay for it all.<sup>263</sup>

Imagine once again that you are impoverished. You are a single parent living in a small apartment with your kids. You dropped out of high school, and you work a minimum wage job at the convenient store down the street. Although the bank was aware of your financial situation, you were able to obtain a credit card. You can barely pay the minimum balance each month, but you try to pay on time. You use the card to buy food and clothing for your kids—you never buy new clothes for yourself. You diligently pay your bill every month, but your car breaks down, absorbing the funds necessary to make your minimum payment. The fees that you are charged put you over your credit limit, and you are charged more penalty fees. Now you are in a hole that you cannot possibly dig yourself out of. That is all it takes.

Now the telephone calls and letters begin. The fees cause the amount that you owe to increase exponentially. You may even receive notice of lawsuits, repossession, or foreclosure, but you do not have a high school education and do not understand what they mean. You notify the credit card company of your difficulties, but you continue to pay. You are too proud to file for bankruptcy. You work too

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<sup>256</sup>Countryman, *supra* note 3, at 20.

<sup>257</sup>*Id.*

<sup>258</sup>*Id.*

<sup>259</sup>Amador, *supra* note 77.

<sup>260</sup>*Id.*

<sup>261</sup>*Id.*

<sup>262</sup>*Id.*

<sup>263</sup>Lander, *supra* note 88, at 210.

hard for that. But it is too late, and you are caught in a downward spiral. You have become a statistic. You have a significantly greater risk of increased stress, family violence, mental illness, divorce, and suicide. You feel totally alone, and there is no one to protect you.

It is time to protect those in our community who need protection the most. Creditors have a right to payment on credit that they honestly and fairly extend to customers. However, when these creditors know of the financial difficulties of a consumer and extend credit for the sole purpose of profiting from the consumer's misfortune, they must be stopped. Judges and legislators alike must follow the lead of Judge Triozzi in *Discover Bank*. Judges must recognize the plight of the impoverished and create common law recognizing improvident extension of credit until the time when statutory law can be passed to put an end to the problem of improvident extension of credit.

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