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Advancing the Consumer Interest has been designed to appeal to professionals who explore consumer problems and help to shape consumer behavior and consumer policies. This includes teachers in higher and secondary education, researchers, extension specialists, consumer affairs professionals in business and government, journalists, lawyers, students in consumer science, and other practitioners in consumer affairs.

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Terrorism, Patriotism, and Consumerism

On September 11, 2001, a brigade of subversive, anti-American, anti-Western, fundamentalist religious extremists, cloaked in the rhetoric of the Islamic religion and anti-Semitism, and disguised as ordinary members of the American working class, successfully hijacked four passenger planes. They used the planes as suicide missiles to destroy the World Trade Center—a cultural symbol of the huge material prosperity that has been generated through the secular, international, consumer-oriented marketplace; and an architectural symbol of the stratospheric heights that have been scaled through the complex technology of modernism. Steering clear of the Statue of Liberty, the anti-modernists aimed their commandeered weapons at an icon of commerce and consumerism.

More than three thousand people disappeared in flames, including rescuers who became victims themselves. Millions of people were separated from those who perished by at most a few degrees of familiarity.

MICHAELLA SILBER AND *NEW YORK TIMES* FRONT PAGE, SEPT. 12, 2001

Television played and replayed the explosions until the horror of the wrecked urban landscape was uncomfortably familiar. The world lost its geopolitical balance, and a military alliance took shape to confront "terrorists with a global reach." Meanwhile, Americans struggled to regain some perspective about the changes—economic, social, legal, political—that would necessarily result on the home front.

The horror of the subversion upset habitual complacency about domestic security. Biocrimes spread from New York across the continent. In a flash, it became apparent that the country had misplaced its confidence in the intelligence apparatus, in military power, and in its historically sheltering distance from large-scale terrorist threats. Adopting a positive self-image of our own good intentions and our international politics, we also discounted the hatred many Muslim fundamentalists harbored not just for the U.S. political leadership but for Western cultures generally.

The assault produced strong feelings of vulnerability and premonitions of further catastrophes. In earlier times these feelings might have been designated as "phobic" or "paranoid" but not now—because too many experts and officials were predicting horrible kinds of terrorist attacks in the future. Anthrax "scares" became real worries. Congressional buildings were evacuated while people and ventilation ducts were nervously tested for "biocrimes." A generation taught to beware of anti-civil liberties and anti-immigrant hysteria now found it necessary to consider its own naïveté.

An explosion of concern about security and about the possibility of future catastrophes

sent shock waves through the marketplace and spurred federal and state legislatures to respond immediately to the crisis. An economic depression loomed—as it became apparent that tens of billions of dollars in insurance claims would be forthcoming, and hundreds of billions of dollars in government aid would be requested to help commercial entities, many issues soon arose for those who were professionally concerned with the treatment of consumers.

Those familiar with the events of World War II will recall that consumers then were asked to "do their part." And for the most part consumers did their part, without challenging many policies that diminished their material well-being during the war and for decades thereafter. The urgent retooling for wartime production caused consumer goods manufacturing to brake to a crawl. Wartime procurement policies concentrated market power in the hands of fewer and larger corporations. Savings plans restricted current expenditures. The rationing of food and scarcity of goods became commonplace.

Immediately following "911," the airline business, and the consumers who needed to make use of it, fared badly. But patriotism, communal purposefulness, and an instinct for self-preservation came into play as consumers again "did their part." In the weeks after the attack, those who used all forms of public transportation willingly accepted greatly increased inconvenience as a price and sign of tighter security. They acquiesced to heightened screening and searches at airports (and also at train stations and toll booths and border crossings). They accepted the elimination of curb-side check-ins and electronic ticketing controls, and new ticketing rules. They were ready to comply with more stringent restrictions on in-flight baggage. But there were indications that airline passengers, dissatisfied with many aspects of airline travel prior to the attack, would not respond well to these conditions in the longer term: a dramatic drop in passenger travel suggested that the combination of greater inconvenience and diminished confidence in airline safety was discouraging consumer activity and driving the industry into a downward spiral.

Nor were the bipartisan emergency appropriations for airline and insurance carriers subjects that consumer professionals could afford to ignore, though they sped through Congress towards enactment with a speed that made attention difficult. Consumer advocates worried that taxpayers and travelers were being asked to pay more to save the airlines from poor business decisions and inadequate attention to security and customer satisfaction. It was reported that demands would be made for limitations on the ability of passengers to sue the airlines, as huge numbers of lawsuits were predicted. The policy alternatives required careful study. Should the higher travel costs and curtailed consumer rights be born by all taxpayers, all traveling passengers, or some subset of the above as an acceptable cost of protecting democratic institutions?

Patriotism, communal purposefulness, and an instinct for self-preservation have come into play.

All phases of consumer life were affected directly or indirectly. Consumers cut down on traveling and eating out. *The New York Times* reported that restaurants were avoiding "truffles and fois gras and anything celebratory" on their menus in favor of more down-home and sober fare. Businesses with indirect losses, including car rental companies, vacation resorts, and restaurants, asserted that they required subsidies and tax relief in order to remain solvent and avoid layoffs. Some stores raised the prices of their goods and services to compensate for lost volumes of patronage. The insurance industry sought government aid to curb present and future insurance claims. Nonprofit organizations, including some consumer organizations, faced budget difficulties as revenues from their services and fund raising activities dwindled.

The Department of Justice proposed new measures designed to allow them to keep better track of subversive groups. Wiretapping and detention rules were to be relaxed. Fewer expectations of privacy over the Internet and over wireless communicators appeared to be possible as a consequence of the new proposals. Easier access by state

security agencies to private banking records, telephone logs, stock transactions, and credit card statements appeared to be part of the package.

Was there a coherent consumer perspective on the subject of these new intrusions on privacy? Concern for protecting the privacy of consumer records prior to September 11th was a major issue for several major consumer organizations (although some consumer advocates had argued that combating consumer fraud online required providing greater latitude to enforcement activities). As concerns about security became less improbable than ever, however, (concerns about anthrax and biological warfare, about the safety of the food supply, about the mails, about the energy grid and the transportation system, among others) privacy, in wartime, appeared to be a luxury every consumer group seemed willing to subordinate—if not sacrifice—to the more urgent problem of an antiterrorism campaign.

As military troops mobilized and were shipped overseas, a concern of the military became the consumer problems of the troops. Many in the armed forces had large credit card debts and mortgage payments due, with balances that would grow larger for the duration of their deployment. The Pentagon invoked a law prohibiting excessive rates of interest to be charged to armed services personnel. Consumer protection regulations, particularly for members of the services, serve the interests of defense.

"Racial profiling" found new defenders, as the stakes involved in failing to find criminals rose astronomically, and as prominent targets for suspicion of criminality shifted from African American to Middle Eastern communities. And the issues related to discrimination and profiling arose in the marketplace, too: everywhere from taxicabs to donut shops, as well as on the streets. Consumer advocates had ordinarily adopted a libertarian position on the subject of discrimination, in a marketplace corollary to the principle that it is "far better for one hundred guilty men to go free than for one innocent man to go to prison." But the traditional principle received qualification at a time when failing to apprehend one suspect could destroy a sizeable part of the country, while the cost in pain, suffering and reputation of wrongful apprehension of an innocent person might be recompensable and repairable.

These are only a few of the important tests of policy that emerged from the sad and frightening events of September 11, 2001. The problem of mediating between the public interest and consumer welfare became more complicated than ever in times of terrorism and war.

Whether the wartime policies of the administration would sustain twenty-first century consumer prosperity, or diminish it, became an important unanswered question. Even more important questions, however, were whether consumer leaders would courageously temper several long-held policy positions for the national security and the public good; and whether they would outspokenly oppose, without any temporizing, commercial interests who sought to exploit current difficulties for their own benefit.

GLOBALIZATION AND FREE TRADE

This issue of *ACI* tries to addresses several important consumer problems, including globalization, free trade and consumer welfare. The Reader Reaction in this issue is a response to a previous article, written by Julia Marlowe and Raúl Rivadeneyra Santibáñez, concerning consumer education

about globalization. E. Scott Maynes offers an updated and unqualified defense of free trade—as unambiguously in the consumer interest. Elsewhere in this issue, however, Rhoda H. Karpatkin presents a very different view in her review of Thomas Friedman's book *The Lexus and the Olive Tree.* Also related to this discussion is an article by ACCI's president Mohamed Abdel-Ghany and me, offering an exploration of patent law and the consumer interest that considers among other subjects the effects of globalization and the contrast between U.S. and other approaches.

FINANCIAL PROBLEMS

Two articles and a special section of the Legal Digest concern policy issues related to the financial difficulties of special groups of consumers. Maude Toussaint-Comeau and Sherrie L.W. Rhine present an empirical study of consumers in a middle income, minority neighborhood of Chicago, and offer steps that might be taken to improve access to financial services for black households. Stephen Gardner recommends a series of steps to curb abusive practices by credit counseling services which, all too often in his view only masquerade as friends of consumers in debt. Finally, the Legal Digest records recent decisions related to the regulation of commercial speech and contains a special section concerned with the Fair Debt Collection Practices Act.

THE LAST FREE-STANDING ISSUE OF ACI

ACI: Advancing the Consumer Interest is being absorbed by ACCI's sister publication, The *Journal of Consumer Affairs,* which is ably edited by Herbert Rotfeld. Professor Rotfeld has a wide-ranging understanding of consumer problems, encompassing not only consumer research but also consumer policy. Indeed, a new section within *JCA* will pursue *ACI's* standing mission: to connect consumer research to consumer policy. Those who would have submitted articles to this journal are encouraged to submit them to the *Journal of Consumer Affairs.*

I owe many thanks to the people who have made possible the publication of *ACI* possible during my editorship. Stephen Meili has creatively and carefully edited the Legal Digest, along with his able colleagues and student researchers.

The members of the Advisory Board, Rima Apple, Stephen Brobeck, Michael Greenfield, Jeanne Hogarth, Bonnie Liebman, E. Scott Maynes, and Susan Reverby, have helped in soliciting submissions, in reviewing and reacting to articles, and in many other ways.

The Editorial Board, consisting of Jessie Fan, Ray Forgue, Janet Garkey, Tahira Hira, Irene Leech, and Jeffrey Sovern, helped out as authors, in the selection of reviewers and as reviewers themselves.

"Thanks to the people who have made possible the publication of ACI.*"*

Thanks to the many members of ACCI who have helped by reviewing submissions. Special thanks to Nancy Zucker for her talented layout and design work, Scott Fields and Linda Bradford for copy editing, and Park Printing for its publishing and production services.

Thanks to Anita Metzen, Carrie Paden, and Vicki Edwards, who carried great administrative weight with the mailings, and were patient with the delays that chronically affected their ability to deliver the issues on time.

And thanks, finally, to the board of directors and the members of ACCI for their support of the journal and its independence.

It has been my honor to edit *Advancing the Consumer Interest.* I hope that until now it has retained its interest and usefulness to its readers, and I am confident that the issues it has addressed will continue to receive attention within the *Journal of Consumer Affairs.*

Norman I. Silber
Editor

Global Consumer Education about Free Trade: Emphatically in the Consumer Interest

E. Scott Maynes[1]
Cornell University

Julia Marlowe and Raúl Rivadeneyra Santibáñez have given us welcome suggestions for a consumer education curriculum to address the international marketplace ("Consumer Education for a Global Marketplace: The Need for an Issue and Policy Focus," ACI, Vol. 12, No. 2). Their thoughtful discussion of methods for addressing consumer issues should prove helpful as consumer educators everywhere adapt their curriculums to globalization. In their excellent article, however, they approach the matter of the consumer interest in free trade as a topic that rightly should provoke varying responses from consumer activists from country to country and from issue to issue. This is not their view alone; among today's social activists, indeed, there is a great deal of outright opposition to free trade generally. Think of those impassioned demonstrations at Seattle and elsewhere directed against the International Monetary Fund and World Bank for their role in the furtherance of Globalization and Free Trade. Obviously, the protesters—some identifying themselves as consumer activists, were certain that free trade and globalization are emphatically not in the consumer interest.

My view is exactly opposite. I believe—emphatically—that free trade, and the globalization that accompanies it, is strongly in the consumer interest. Let me make the case, issue by issue.

CHOICE: AN UNAMBIGUOUS GAIN

Freer world trade is in every consumer's interest. It gives all consumers a greater choice of products/brand-models, lower prices, better quality, and--combined--better value for money. Think of Japanese cars and TV's, tennis shoes made in China, wine from France, Chile, and skis from Norway. Etcetera, etcetera.

Free trade confers its potential benefits on everyone: rich and poor, the ignorant and the educated, all races, men and women. Think of losses suffered by Americans because of interferences with free trade, e. g., the cars we cannot import and the higher prices we pay because of the U. S. import quota on Japanese cars, the higher prices we pay on sugar because of our sugar quotas, the higher prices of steel resulting from higher U. S. tariffs on foreign steel. Etcetera, etcetera. Alternatively, think of the higher prices Europeans pay for bananas because of

restrictions the European Community places on the importation of Central American bananas (put in place to protect banana producers in the former European colonies!). Worst of all, think sympathetically of citizens in the former Soviet Union who—if they could buy a car—were restricted to those 2-cycle, 1952 design Trabands. Precious to Soviet citizens; jokes to everyone else.

CHILD LABOR, SWEAT SHOPS, UNSAFE PRODUCTS

Activists would have you believe that Free Trade begets these three evils: child labor, sweat shops, and unsafe products. By contrast, it is my view that free trade offers job opportunities and less safe products (e. g., DDT) that families and consumers in less developed economies accept, even eagerly, because they enable these people to improve their abysmally low standard of living. First, I offer a parable that should enlighten and then I offer a fuller, more careful explanation.

The parable first. It involves my family and the time is 100 years ago. In 1904 my grandfather, George Washington Maynes (sic), a subsistence farmer in Meriden, CT, died. Kicked by a horse. He left behind my grandmother and 5 children. What to do? My grandmother, after consulting others, decided to pull my father—13 out of school to find work that would support his family. My father became an "office boy"—and then more—in a local manufacturing company. And his earnings did sustain the family until the others finished school and became financially independent. Child labor? Of course. But how else could they cope? In those days the U. S. was not affluent enough to have a Social Security system. And the family had no other resources. And so it is in many "less developed" countries. Productivity in these countries is very low, generating incomes so low that many families are in desperate economic straits. Foreign trade, e. g., the introduction of shoe factories, offers employment to children, "low" wages, and "poor" working conditions—sweat shops—that people accept because, for a desperately poor family, they represent "opportunities" for a family to improve its economic lot. One hundred years ago in the U. S. campaigns against child labor and sweat shops finally succeeded because U. S. workers had finally achieved the levels of productivity that enabled employers to pay higher wages and to offer better working conditions.

Similarly, many less developed countries suffer from less safe products, e. g., the insecticide DDT and unsafe water. Not because they want them, but because the country is not sufficiently productive and hence, affluent enough, to pay for safer, less environmentally destructive products.

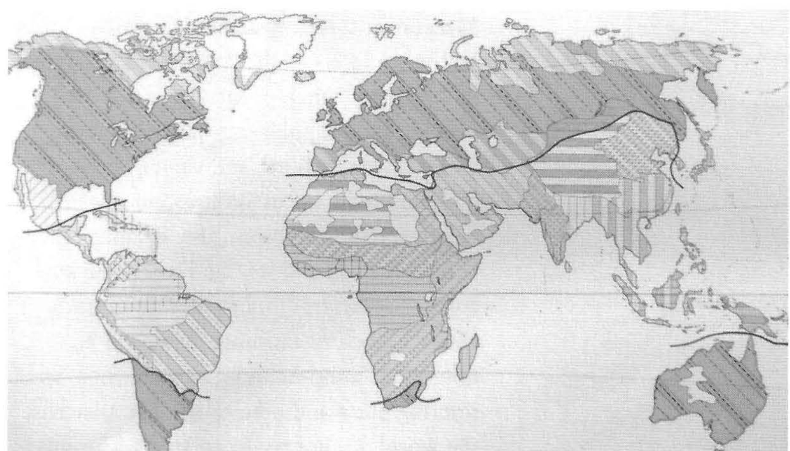
The important insights: child labor, sweat shops, and unsafe products are traceable to poverty, which is in turn traceable to low productivity. When national productivity increases—abetted by free trade—these countries will be able to eschew child labor and sweat shops and to opt for safer products, just as the United States did early in the 20th century.

"When national productivity increases —abetted by free trade... countries will be able to eschew child labor and sweat shops and to opt for safer products..."

A "FIFTH COLUMN" FOR DEMOCRACY

Free trade constitutes a fifth column on behalf of democracy.[2] The individualism central to the conduct of business, whether for import or for export, leads to a preference for political democracy. All the players—executives, suppliers, employees, lenders, and advertisers—march to the tune of the market. And the market makes them flexible, opportunistic, and individualistic.

Another facet of free trade—the negotiation and execution of import and export



The world mapped according to protein consumption. (NY Times World Atlas)

contracts by organizations in totalitarian countries—always involves talk and contact with foreigners. The talk inevitably exposes those in the dictatorships to new and challenging ideas, to different ways of doing things, and to the possibility that the foreign countries they are dealing with enjoy better living standards than their own country. In short, all these contacts are eye-openers that are likely to remake the participants into prophets on behalf of free enterprise.

In the long run, free trade persistently and insistently pushes totalitarian countries towards more liberal conditions, usually culminating in political democracies and market economies. Think of the following dictatorships turned democracies: Spain, Portugal, Poland, Hungary, Korea, Taiwan, and perhaps Russia. Will China, now a full member of the World Trade Organization, be next?

"Free trade persistently and insistently pushes totalitarian countries toward more liberal conditions, culminating in political democracies and market economies."

THE SEVERAL FACETS OF GLOBALIZATION

Is the Americanization of the World approaching? Critics assert (non-sympathetically!) that multi-national corporations, "selling" American products, culture, and values will make the world an American World—to the detriment of French, Irish, Muslim, Indian, you-name-it products, cultures, and values. Historically, this has always occurred in some degree. Hegemonic powers —in historic sequence China, Portugal, Spain, Britain, and now the United States—have always done this. It seems to be one of the perquisites of hegemony. So it should come as no surprise that we see that Big Macs, rock n'roll, American movies and TV, and other facets of the American scene, seem to "capture" much of the world.

One should point out that, even though the products, culture, and values of the multinationals are ubiquitous, no one anywhere is required to buy, use, or adopt them. Should they so choose, the French can still enjoy lengthy, traditional lunches in traditional French restaurants. It should be noted that multi-national corporations, while offering pizza and other alien fare all across the world, do not try to persuade Muslims (or Hindus or Buddhists) to alter their religious views.

Further, it could be argued that some of the products of multi-nationals have won out in a fair and fierce world competition. Fast-food restaurants with their swift service and standard products—the application of the franchising concept pioneered more than 100 years ago by Singer Sewing Machine—serve an almost universally useful purpose. Perhaps some of the products and services offered by some of the multi-nationals establish better standards that others must emulate.

Finally, one should note that people everywhere are free to choose products, cultures, and values different from those promoted by the multi-nationals.

MULTI-NATIONAL CORPORATIONS AS AGENTS OF TECHNOLOGICAL ADVANCE

Multi-national corporations constitute, I submit, the most effective device ever concocted for the spread of technology. To begin with, the multi-nationals are masters of the latest technology, having usually bested others in a fierce competition. When they "go in" to a new market or new country, would not one expect them to embody in their facilities, their products, and their organization the best technology of which they are aware? Otherwise, how can they continue at or near the slippery summit?

One could argue that American and other Western research universities are also fruitful agents of change. They are after all, the source of most (much?) new science and technology that the multi-nationals use, and they train the leading employees of the multi-nationals. Unquestionably, some of the new science/technology is directly transferred across the world by the international university system. But it will largely be the multi-national corporations who put the new technologies in place in countries around the world.

Finally, do remember that even if American multi-nationals are most numerous, this breed has its home bases in advanced countries all across the world.

"MONEY TALKS": THE LIMITED POWER OF MULTI-NATIONAL CORPORATIONS

The criticism is encapsulated in the aphorism, "money talks." Some fear that multi-national corporations will control decision-making across the world. The fear is understandable: multinationals directly control enormous resources and large labor forces. The revenues of some companies exceed those of some nations. But the truth is that the power of multi-nationals, while great, is still limited.

First, they are continually involved in a continuous struggle for their existence. Think of those who have failed, or come close to failing: Pan American World Airways (for whom the Boeing 747 was designed), Westinghouse Electric, Chrysler who nearly failed in both 1983 and 1991. Formerly, names to conjure with.

Second, in issues of paramount importance, very large corporations have lost out within their home country. This was the case in the early 1960s when Environmentalism first became a major concern. The natural position of Business was to oppose various measures to improve the Environment—with clean air, clean water, etc. After all, these measures would increase business costs and hence threaten profits. Business had enormous financial resources with which to pursue its position. And legions of supporters—its executives, advertisers, employees, even union members whose jobs might be at stake. Yet the Environmental Movement, composed of The Sierra Club, outdoorsmen, do-gooders of various stripes—a coalition with relatively small financial resources prevailed. Clean Water and Clean Air Laws were adopted, which did indeed yield cleaner water and cleaner air.

Third, in democracies all across the world, Conservative political parties are typically the parties of Business, with business "naturally" providing strong financial support. Yet, the record over many countries and long periods shows that, typically, Conservative Parties and Liberal Parties alternate in power with neither in "permanent" control.

SUMMING-UP

For all these reasons I believe that Free Trade, and its accompanist—Globalization—are in The Consumer Interest.

ENDNOTE

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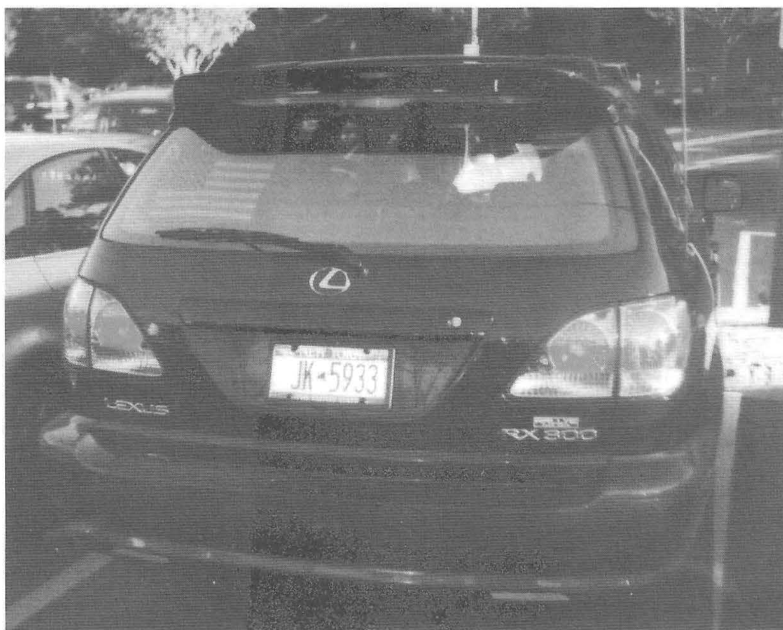
[2] The meaning of the term "fifth column" is not as readily understood today as in past, but may in light of recent events regain its currency. The phrase originated in the 1930's to describe organized subversives who were working within Spain to further the political and military aims of forces opposed to the existing regime.

Rethinking Globalization

Rhoda H. Karpatkin[1]



Thomas L. Friedman, *The Lexus and The Olive Tree: Understanding Globalization.* New York: Anchor Books, 2000.

It's sobering—indeed painful—to read Thomas Friedman's paean to the new technology, to the ensuing globalization, and to America's transcendent greatness, all so soon after the September Eleventh attacks and everything that has followed. The book, first published in 1999 and updated in 2000, has both presaged those grim events and been overtaken by them.

Globalization has been suffused with new significance since September 11, and Friedman's book consequently takes on even greater relevancy. In a world that suddenly has grown much smaller and has been plunged so quickly into turmoil, we can certainly use a cogent explanation of what globalization is all about. Friedman's book helps, even if it's far from everything we need and even if the shortcomings of *The Lexus and the Olive Tree* make you wonder about the accolades by the 16 publications quoted in the book.

Friedman defines globalization as "the inexorable integration of markets, nation-states and technologies to a degree never witnessed before—in a way that is enabling individuals, corporations, and nation-states to reach around the world farther, faster, deeper and cheaper than ever before," and the world to reach into them in the same way. This globalization, he says, "is also producing a powerful backlash from those brutalized or left behind by this new system."

Friedman describes how "the new, very greased, interconnected system called globalization," the dominant international system at the end of the twentieth century, "... shapes virtually everyone's domestic politics, commerce, environment and international relations." Globalization means "the spread of free-market capitalism to virtually every country in the world." It creates its own set of economic rules about opening, deregulating and privatizing a nation's economy, to make it more "competitive" and attractive to attract foreign investment.

The dominant culture spread by globalization is American, and "Americanization"; its defining technologies are computerization,

miniaturization, digitalization, satellite communications, fiber optics and the Internet, all of which lead inexorably to global integration. In this system, he correctly notes, the US is now the "sole and dominant superpower, and all other nations are subordinate to it to one degree or another," although the balance of power with other nations still matters for the stability of the system.

In the new globalized world, the traditional balance between nation-states and global markets is fundamentally changed. Millions of global investors comprise an "Electronic Herd" who move money globally with the click of a mouse. The Herd has huge impacts on nation-states, even great enough to cause their downfall. And in this world, there are newly created, angry, "superempowered" individuals like Osama bin Laden, who although not states, act directly on the world scene, in reaction to globalization.

Friedman calls his book a guidebook to this new post-cold war era. The title of the book bespeaks its thesis: how the quest for material betterment, the "Lexus," overruns and overpowers the community and environmental and traditional values of the "olive tree." Not surprisingly, the "Lexus" values of this brave new world are not shared by all that find themselves forced to live within it. Some cling to their pre-globalization or non-globalization values, their "olive tree," which represents everything that "roots us, anchors us, identifies us and locates us in this world —whether it be belonging to a family, a community, a tribe, a nation, a religion or, most of all, a place called home." It provides "the feelings of self-esteem...the joys of individuality...that are essential for human survival." To be a complete person "you must be part of and rooted in an olive grove." The olive tree is what makes people "profoundly human."

Friedman seems to respect and sympathize with the olive tree, and his sections describing this rootedness are also a meaningful rendering of some of what globalization undermines and threatens. He portrays in this discussion the dark side of globalization. He observes other ways it is destructive: its pressures towards cultural homogenization and its destruction of the environment and of ecological diversity (turning culture into a "global mush" and the environment into a "global mash,"especially in the poorer countries). His description gives us insight into some of the concerns of the millions of people, who we now understand reject such globalization and America's role in it, and the hundreds of thousands of people who actively protest it. He tells us about the critics, and about their anger. And about the backlash that results when so many people care so deeply about the values globalization threatens.

Unfortunately he doesn't present us with all the information or insight we need for a cogent analysis.

Friedman gives us insight into some of the concerns of millions of people who we now understand reject globalization and America's role in it.

He sees how the profit motive can lead to "commercialization and exploitation of every cultural icon". But his lame response is that we need "a caring middle class and elite that are ready to worry about these things," and that wealthy civic-minded people like the Rockefellers should set up museums and parks. His is a "market" solution rather than a regulatory one.

He sees the growth in the income gap between poor and rich, caused by the global winner-take-all economy. He acknowledges that it's unfair, and an Achilles heel of globalization; and he urges in the last chapter that America has a special responsibility to make globalization sustainable so we can benefit from it. (He proposes a combination of social-democratic style programs to help Americans benefit from or survive in the new economic era, and limited-time, minimum safety nets in other countries.) But he believes the alternative to globalization is a closed, regulated economy that would impoverish society. Any country, he says, can choose prosperity. It's merely a matter of choosing the right policies; any country can plug into the Internet and find investors. The outcome is determined by how a country chooses to organize and manage its economy. And, Friedman says, globalization has raised living standards higher and for more people than ever before; while the gap is getting wider, the floor is rising.

He acknowledges that it's easier to fire workers in the global marketplace, but he says it must be so in this system: "The easier it is to fire workers, the more incentive employers have to hire them." If you can freely displace workers with new technologies, he says, the benefits will generate greater prosperity and ultimately more job creation

He is chillingly on the mark when he describes how globalization evokes great resentment of the United States, and invites and facilitates terrorism. The Iranians, he reports, have a not uncommon view of America: they call it "the capital of global arrogance." He quotes a Russian leader who describes us as a "country infatuated with its own power," and also a Japanese letter that criticizes "American hubris." These views are typical, he says.

"There's much to be learned from Friedman's book, but its warnings about the downsides of globalization are more helpful than his too facile responses."

He describes what motivates bin Laden, his followers, and other alienated people, people he calls the "Superempowered Angry Men." It is painful now to read the words of the terrorist who bombed the World Trade Center in 1993, who stated in court that his goal was to cause the towers to topple.

Globalization, Friedman says, provides not only reasons to hate America, but "much greater power, as individuals, to pull the trigger," and to do much greater harm than ever before. That, he says, is the greatest danger. The logic of the angry men is that their own states no longer represent the power structure. America does, and that is why it should be brought down. (He reminds us that the Roman Empire contained marvels of engineering skills but fell victim to the great roads it had built.)

He writes that what bothers these angry men is not only American power, but our claim that our values are superior, when they appear to others to be a "soulless consumerism and mindless technology worship." America-haters, he says, point to America's atomic bombs, firebombs, chemical warfare and embargoes, and the damage they have done. However painful today, it's important to understand these views. And the views of other critics of the brave new world that Friedman relishes.

While he presents these views cogently, Friedman is dismissive and unanalytical. He tries to offset the criticisms and critics with the assertion—backed up only by anecdotes —that they are nevertheless eager to buy into our system of propserity.

A better approach, for example, was pursued by Jessica Matthews, the President of the Carnegie Endowment for International Peace, speaking in an interview with Charlie Rose after the attack. She, like Friedman, stressed that it was important that Americans see ourselves as others see us. Indeed, this is now a widely expressed view, and the terrorist attacks have generated a public dialogue that can lead to more insight into America's conduct as a global power.

Matthews pointed out how objectionable America's conduct appeared to the rest of the world: our "take-it-or-leave-it approach to international governance," and how "we choose the bits of international law we want to apply to ourselves." The poor, she said, feel the rules of globalization are against them, and many focus on their envy and their hatred.

Others, Matthews said, base their hatred on religious extremism. She referred to the many global treaties and initiatives where the US split with Europe in the last few years, including those relating to the international court, biological weapons, small arms, Kyoto global warming accords, arms control, and weapons of mass destruction.

There's much to be learned from Friedman's book, but its warnings about the downsides of globalization are more helpful than his too facile responses. Unfortunately, while he can see and report how others see us, he fails to draw helpful conclusions from those insights, and that is what is badly needed today.

It made sense to update this best-selling work, as Friedman did. He should do it again. In addition to the "I-told-you-so" revision he might be tempted to write, he could add some significant improvements. Here are some suggestions:

• He should round out his description of the

trends and currents of globalization with a serious treatment of its institutional governance and power mechanisms: the WTO, the World Bank, the IMF, and the many multilateral agreements that shape globalization, including NAFTA, GATT, and TRIPS. In fact, the global architecture is far more than the amorphous, uncontrolled free-flowing world he has described. Consumers, governments and companies do not all have equal power to be "shapers" of the world, as he believes. Instead it is very much governed by written treaties and agreements that include rules written for the benefit of powerful countries, and are disadvantageous to poor countries and citizens. The book would have benefited from a serious presentation and analysis of the roles each of those very powerful institutions and agreements plays in globalization.

• While he refers several times to protests against the WTO in Seattle, he shows a curious lack of curiosity about the reasons for the protests. He ventures vague references to the WTO but provides no information about the WTO's very significant global powers and operations under the GATT agreement. More information is needed.

• He should temper his seeming infatuation with those government and industry leaders who are the beneficiaries and drum majors of globalization. While he quotes with great frequency from his apparently chummy conversations with the famous and successful—not very high quality research, in my opinion—there is little critical analysis of either their views or their anecdotes. He should add some.

• He should add balance. There is a troubling dearth of coverage of advocates of other views. For example, he cites many times, on environmental issues, the views of Robert Shapiro, the Monsanto president who has sought to foist genetically modified seeds and foods on the global public while fighting vigorously to prevent the labeling that European and American consumers have urged. But in his discussion on the impact of globalization on workers and the environment, there are no conversations with leaders of American environmental or consumer or labor organizations.

• He should be more attentive to the structural reasons that globalization has benefited rich over poor countries. Complex issues of history, politics, geography and geopolitics, including the imperialism of earlier centuries, cannot all be resolved by waving the globalization wand, as he seems to suggest.

With so much evidence that the entrenched global trading system favors the rich countries over the poor, and with the rich countries resisting the efforts of the developing countries to correct this, it is all the more appalling to read the casual, cavalier, way that Friedman dismisses the anti-globalization protestors. He doesn't probe or analyze the viewpoints of the civil society organizations whose concerns have largely been ignored. The book would have benefited from research in or at least in-depth conversations with serious critics of globalization. Instead, there are a few anecdotes about protestors who are easily bought off by stock or job offers, cheap shots not worthy of the book or the author.

In fact, many responsible citizen organizations all over the world have been critics, in one way or another, of the nature of globalization as it is now occurring, and of its damage to countries, people and values. They are not hard to find and they are not insignificant. Labor, environmental, consumer and other organizations have spoken out. Consumer organizations include, to name a few, Consumers Union of United States; Consumers International, an international organization with more than 250 member organizations all over the world; the Transatlantic Consumer Dialogue, composed of about 60 organizations on both sides of the Atlantic; and Public Citizen. These—and many other "civil society" organizations—have had considerable public visibility and effective websites that would reward a

"Many responsible citizen organizations all over the world have been critics...of the nature of globalization as it is now occuring, and of its damage to countries, people and values."

researcher with cogent, reasoned viewpoints to balance the views of the Shapiros and other fans of globalization as we know it today. A brief summary of their concerns would include the following:

"Powerful global institutions...make far reaching decisions, but are not elected by or accountable to any citizen interests."

- The WTO, the World Bank and the International Monetary Fund against whom protests have been directed, are powerful global institutions that make far reaching decisions affecting citizens, but are not elected by or accountable to any citizen interests. There is a lack of transparency in their decision making and their operations, and no public accountability for their outcomes. Business interests have a hugely powerful effect on those institutions, but civil society interests have none. Developing countries, dependent on outside financial interests, are virtually powerless in the WTO and are dictated to by the IMF and the World Bank.

- The WTO dispute resolution procedures determine citizens' rights and protections in areas involving the environment, food, and goods and services, but citizen groups have no right to participate, or even to file a friend-of-the-court brief. This is in direct contravention of the policies and practices that govern the legal rights of citizens in their own countries.

- The global trading system has driven a race to the bottom in labor costs, with a loss of jobs and a weakening of labor rights in developed countries and an increasing number of sweatshops in developing countries (Friedman knows this, but he claims such vulnerability in the labor market will ultimately be a benefit to workers, and the enormous market power of consumers will vanquish the sweatshops. Neither contention can withstand reality testing.)

- Patent rules in the TRIPS agreement have been invoked to protect pharmaceutical company profits to the detriment of public health needs. They have largely worked to protect the power of the drug companies to charge high prices for essential drugs, and therefore to impair access to drugs for the poor in developing countries. While access to affordable drugs was previously seen as a public health problem only in developing countries, especially in connection with the AIDS crisis, Americans are getting an unfortunate dose of reality now about that issue. The American government, because it wants to assure adequate supplies of Cipro at affordable costs in the event it is needed for a large number of anthrax cases, must contend with the patent rights of the Bayer Company.

- The General Treaty on Services, which calls for the liberalization of electricity, water, and telecommunications, among other services, does not assure that national regulatory bodies can protect consumers' right to access and other consumer rights in these fundamental necessities.

- The current global structure undermines national government powers to establish and maintain food safety and consumer information labeling rules. The most notorious and visible instances are the persistent strong-arm tactics used by the U.S. to prevent— in our country and in Europe—the labeling of genetically modified foods, to afford consumers the right to choose and their right to information.

- Global Trade Agreements and WTO rules and operations have benefited richer countries to the disadvantage of developing countries.

The protestors have urged economic and political reforms to alleviate the unfair outcomes to the poor, a more democratic and transparent global governing system, and a reevaluation and correction of existing global trade agreements that have eroded or destroyed the rights and protection built up by the U.S. and Europe over hundreds of years. The details of their criticisms, and their suggestions for change, are easily available, and I would hope that a future edition of this book will pay serious and respectful attention to their criticisms and their views.

The book should have a postscript as well.

Friedman made much in his book about how globalization leads inexorably to the spread of democracy to countries that do not practice it. Yet, we find ourselves now with actions by our own government that undermine our own democratic precepts.

Even as our government pursues its antiterrorist war, and describes it as necessary to protect American values, some of those same values are under siege by the Executive Branch. In rapid succession, the government has unveiled what the New York Times has called "dubious departures from American principles": secret military tribunals to try terrorists, wiretapping conversations between some prisoners and their lawyers, holding hundreds of detainees without revealing their identities or the charges against them. They've done all of this without consulting Congress, without showing a willingness to account to Congress, and without providing for citizen input into such deviations from our fundamental American rights. America's essential values are grounded in the rule of law, and our country must beware of any attempts to undermine it.

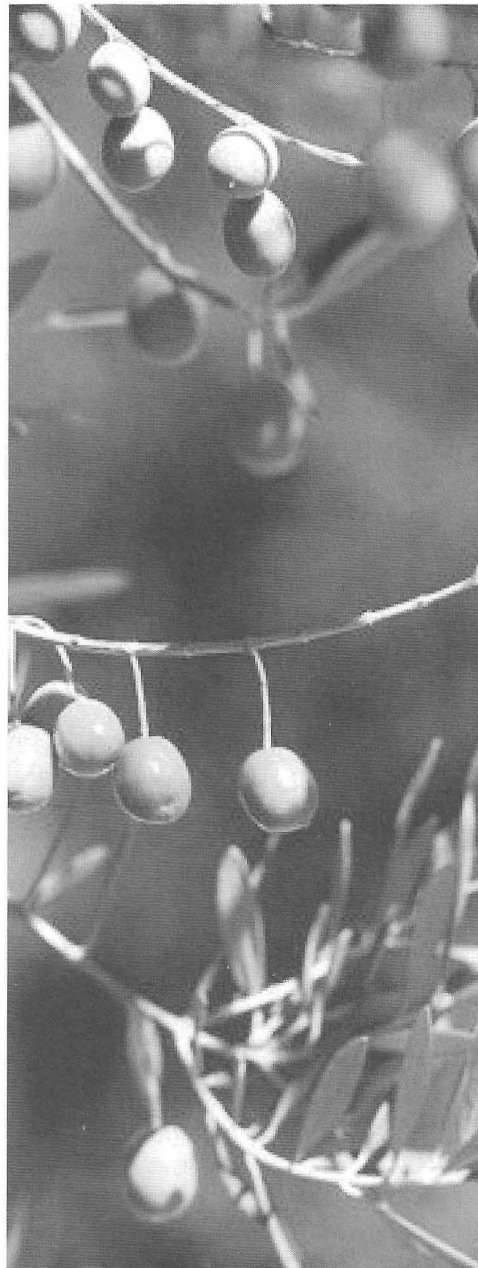
At the same time, America has become allied, in our battle to protect our values from terrorist attacks, with some governments whose political, social and economic realities are antithetical to the political democracy and other values we cherish.

Today, even Friedman is likely to agree that the answers are far less glib and facile than he suggested in his book. As with other theologies, the theology of free trade does not hold the answers we need. And the post September 11 challenges are not only to find the ways to fight terrorism, but to deal with the harm and alienation that have resulted from globalization, and with the causes. Our government should be more thoughtful about its quest for continued primacy in world trade and continued global supremacy. And it should rethink the very nature of the globalization it has pursued.

Perhaps Friedman is already at work on the next book, and it will come closer than this one to providing the analysis we need in these troubling times.

ENDNOTE

[1]Rhoda H. Karpatkin is the President Emeritus of Consumers Union



FEATURE ARTICLE

The High Cost of Invention: Patent Law and the Consumer Interest

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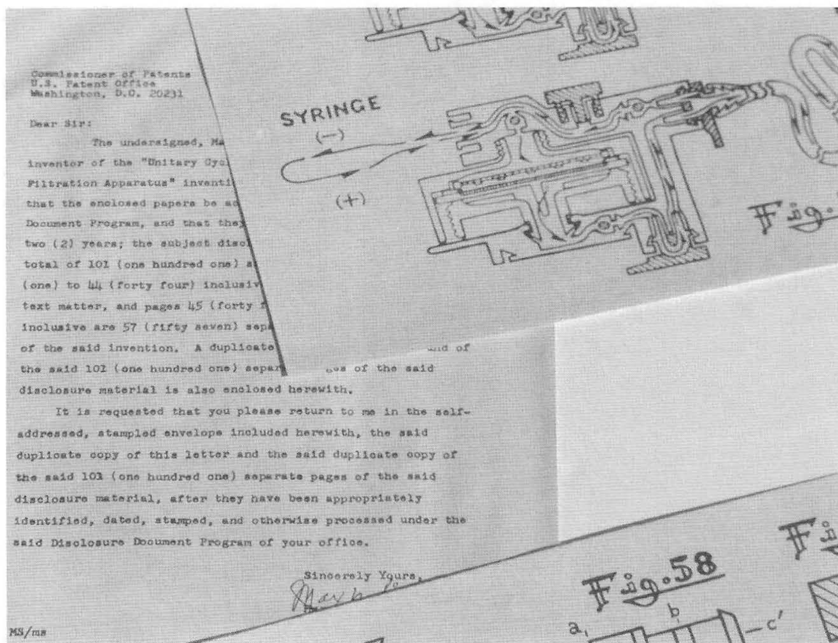


In the fall of 2001, an outbreak of the virulent disease called "inhalation anthrax" spread around the country through the mails, prompting widespread concern about the availability of antibiotics to treat it. A.G. Bayer Pharmaceuticals manufactured the principal drug of choice—the patented antibiotic CIPRO (ciproflaxacin). The company faced intense pressure to let other drug manufacturers produce generic versions of CIPRO to minimize hoarding, alleviate anticipated shortages of the medication, and to reduce its escalating cost. In Canada, the government met the public health challenge by exercising an emergency provision of its patent law rules, which brought the company's Canadian patent monopoly to an end. Bayer strenuously opposed the Canadian action however. In the United States, the company, with two years remaining on its seventeen-year patent monopoly, stood upon its legal right to leave prices high and supplies less than abundant. Substitute medications were available, a spokesman said, and patent protection existed as a necessary reward for having invested in the development of a superior product.

These different approaches in the U.S. and Canada illustrate the different political balance that has been struck between consumer and patent rights in the two nations. The difference has seldom been more apparent; but the problem of determining an effective and appropriate inducement for innovation is centuries old. The Venetian Senate, in fact, granted a ten-year blanket of protection for "new and ingenious devices" as early as the sixteenth century. During the Renaissance, monarchs used the award of patents to try to hasten the improvement of agricultural methods and military technology. Concepts related to the copyright, which permitted the

authors of literary works to benefit from their authorship through a limited monopoly on rights of publication, emerged during the Enlightenment.

Patenting inventions and protecting creative works was accordingly well-known to the American colonial legislatures. They established a diversity of patent rules that both confused and hindered inventors (Merges, 1992). When the Framers addressed the subject of patents in the United States Constitution, they consolidated the power to create and regulate patents in the hands of the federal government. The Constitution provides in Article I, section eight, that that "The Congress shall have the power . . . to promote the progress of useful arts, by securing for limited times . . . to inventors, the exclusive rights to their discoveries." The basic principle guiding the development of patent law has in succeeding years been that, to qualify for a patent, an invention must be novel, useful, and not obvious. The volume of patents granted continues to rise, with the number of patents issued by the Patent Office coming to 157,497 in 1999.

Patent law in the United States changed significantly in 1994 when the United States decided to adhere to the General Agreement on Tariffs and Trade ("GATT"). This agreement mandated several changes to American law to bring it into harmony with the new global standard. Up to this point, the patent laws of the United States provided seventeen years for protection, ordinarily running from the day the patent was issued. Under the GATT agreement, however, the new time allowed by patent protection is a variable period that can run up to twenty years, counting from when the application is first filed with the Patent and Trademark Office ("PTO") (Lemley, 1995).

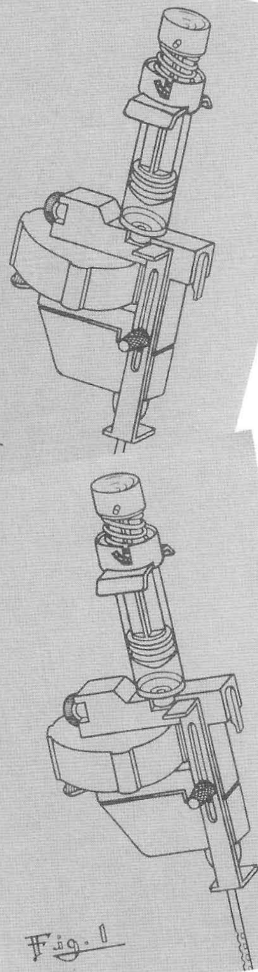
Specialists have conducted theoretical and empirical studies of the patent system and its legal regime—industry by industry and doctrine by doctrine—to see whether inventors' rights have been overprotected. They have often inquired, that is, whether patents foster anti-competitive monopolies and raise prices without generating sufficient compensatory benefits. The tests applied by patent officers and courts, and the studies by scholars, however, often assess whether the rules, or the patents granted under them, are economically efficient rather than whether they are deleterious to particular groups of consumers or to consumers as a general class. To claim, as its defenders do, that the "public interest" is generally served in the long run by patent law may or may not be correct; but this is not the same as asserting that consumer interests are generally well-served.

Whether consumer interests have been given their due regard by the patent law regime is a different inquiry from the ones that are usually undertaken by scholars who are not consumer professionals, and, unsurprisingly, it is an inquiry to which further attention should be paid. Do consumers benefit, overall, from American patent laws? Are the economic rewards from innovation sufficient to outweigh the damage done by officially sanctioned monopoly power? Will consumers profit from the new rules that have been crafted, in the interest of globalization, for extended patents? The topic is a broad and complicated one, and only a beginning can be attempted here.

RATIONALIZING PATENT PROTECTION

There is a consumer interest served by granting patents of limited duration. Patents have the capacity to stimulate free market competition by increasing the consumer options through various new inventions and ideas. Because patentees must publicly disclose their inventions to obtain patents, the system encourages other inventors to design around or develop their own improvements. Consumers then are presented with an array of new and improved inventions, as has happened recently in such fields as pharmaceuticals, computer science, and biotechnology. Without the patent right, inventors would likely be induced by self-interest to rely on trade secret protection that would typically keep new information permanently from the public.

Two general reasons have been offered for the existing government system of patents, which protects and nurtures investment in



inventions for such a long period.

First, inventiveness promotes economic well being, but it does not thrive without inventors who can reasonably anticipate the prospect of monetary gain (and investors who can reasonably anticipate gain) as the result of their success. Without protective rules and penalties for violating those rules, anyone could copy any commercially successful new idea or item before the recoupment of the costs of invention, including a reasonable bounty for the successful act of creation. Rational competitors would seize the opportunity to capitalize on the investments made by others, discouraging the inclination to sponsor invention.

Second, governmental macroeconomic policy objectives are said to be served by the patent law. One specific policy claim, for example, is that lengthy patent protection protects small businesses from predation by larger businesses. A new idea, product or process is the often only way that the smaller business can compete with the larger, more dominate, businesses. Our patent laws are said to protect and foster the growth of small businesses by allowing them to compete against the larger businesses without fear that their sole advantage will be prematurely upended.

An imbalance between anemic antitrust enforcement and strong intellectual property protection may be producing a significant anti consumer impact.

More generally, the American patent system, it is said, creates a positive incentive for investment in research, which sustains international economic competitiveness over extended time periods. Patent law, like monetary or fiscal policy, is said to be a public policy tool that either promotes or restricts national economic growth according to the economic incentives it generates. (Symposium, 1990).

CALCULATING THE COSTS OF ANTI-COMPETITIVENESS

Notwithstanding the benefits of a system of long-term patent protection, the costs of that protection may be borne disproportionately by consumers. The biggest costs will result from the officially sanctioned monopoly power that is generated by the grant of a patent. Evidence of an aggregate anti-competitive impact of patents is difficult to come by. It is not difficult, however, to locate individual allegations of the detrimental impact of monopoly power by consulting court decisions in the area of patent antitrust law.

Unless more aggressive antitrust enforcement becomes the norm, it appears that the impact of the intellectual property and patent laws on innovation, price structures and the availability of products will continue to be damaging. Robert Pitofsky, the Chairman of the Federal Trade Commission, recently suggested that an imbalance between anemic antitrust enforcement and strong intellectual property protection may be producing a significant anti-consumer impact. "It is clear that both intellectual property protection and reasonable antitrust enforcement will encourage innovation," Pitofsky wrote. "Intellectual property rights subsidize investments in innovation [while] Antitrust . . . prevents dominant firms from harming or retarding innovation. Serious problems arise when either regime—intellectual property protection or antitrust—is accorded disproportionate weight." Examining the history of antitrust enforcement, Pitofsky observed that it had "often if not always been [excessively] sensitive to the value of innovation." (Pitofsky, 2001).

A striking example of over-sensitivity to the possibility of discouraging innovation is the Federal Circuit decision in *CSU v. Xerox Corporation*, where the court concluded that a patent holder could refuse to license anyone, regardless of the intent of the patent holder or the effect of the refusal on competition. The court ruled that the refusal was exempt from the antitrust laws in all but extreme circumstances. In doing so, the court "leaped from the undeniable premise that an intellectual property holder does not have to license anyone in the first instance to the unjustifiable conclusion that it can select among licensees to achieve an anti-competitive purpose or can condition a license . . . to achieve an anti-competitive effect." (Pitofsky, 2001).

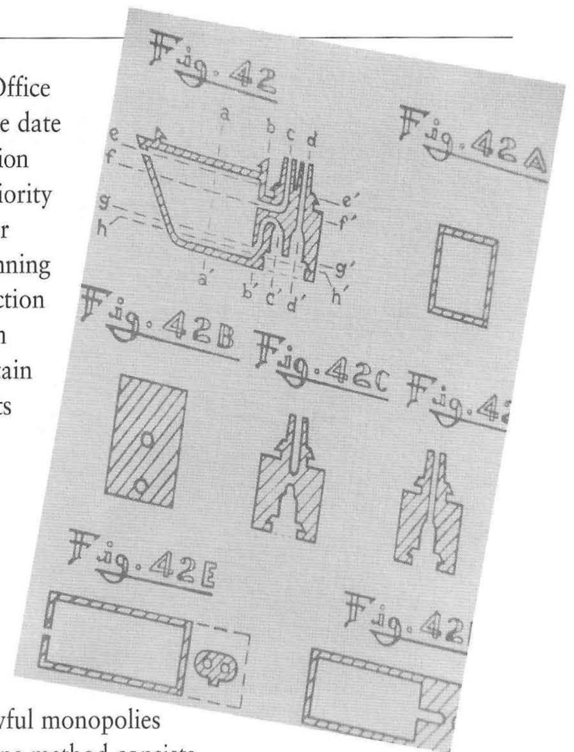
QUESTIONING THE LENGTH OF PATENT PROTECTION

Are inventors being protected for unnecessarily long periods of time at the expense of consumers? In the United States rights have been lengthened to exclude others from making, using, or selling the claimed invention for twenty years after the filing date of the patent application. Extensions to compensate for litigation subsequent to filing are also possible, particularly in biomedical fields.

Faced with a choice between the conferring monopoly power for a longer period of time or opening previously monopolized lines of manufacture to the competitive marketplace, it would seem appropriate to place a strong burden on the advocates for longer periods to demonstrate that returns are otherwise insufficient to induce investment. In the fields of electronic technology, computer science, and biomedical research, the evidence suggests that the value of investments is great enough to generate, if anything, over-investment.[1]

Representatives of several industries have claimed that their protections have been adversely affected by the WTO Trade Related Aspects of International Property Rights, or "TRIPS" agreements, which they claim have effectively reduced patent protection. In the biomedical field, lobbyists have complained that developing nations are being permitted to copy patented medicines under public health exceptions. They also claim that since they spend more time on average litigating for their patents, and since the date of application rather than the date of the grant may trigger the patent clock, they have less protection under the new system notwithstanding the change from a seventeen to a twenty-year grant.

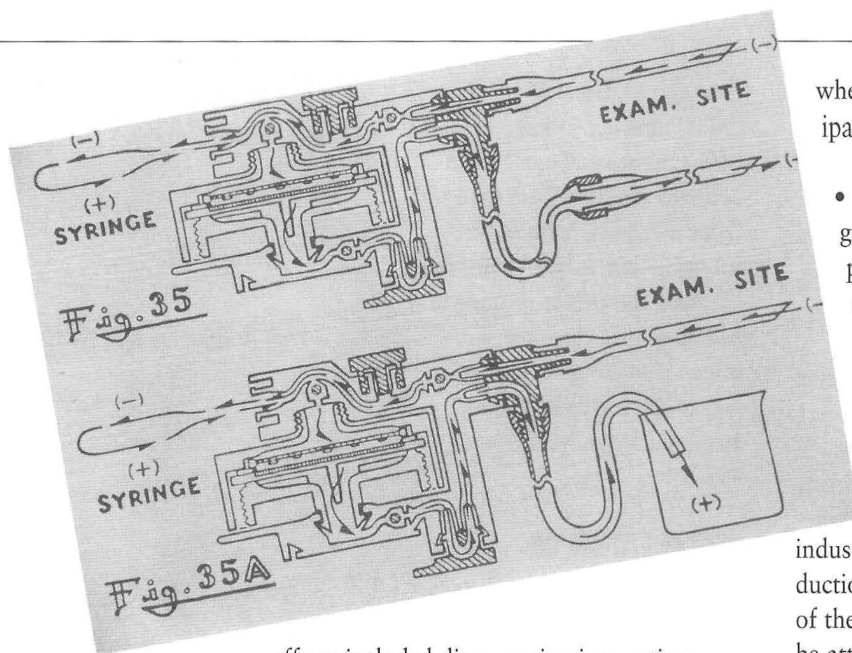
At least one study suggests that there is less to the argument about shortening than meets the eye. Overall, empirical analysis by Professor Mark Lemley found that the average patentee obtained an extra 253 days of protection under the new law when compared to the older system of 17 years. Part of the reason is the new law's permissive filing of "provisional" applications. These allow inventors to file such applications with the Patents and Trademarks Office (PTO) in order to have the date of the provisional application count as the invention's priority date in disputes with other inventors but to avoid running clock on the patent protection period for another year. In essence, inventors can obtain extra time for their patents at minimal cost. (Lemley, 1995)



CURBING ABUSE OF PATENT RIGHTS

Once patent rights are commercialized they are subject to misuse by patentees to further unlawful monopolies to impede competition. One method consists of illegally tying a patented product to a second, non-patented product. Another method is to retard competition by pursuing the right to claim infringement against a competitor who makes "insubstantial" changes to an invention. Sometimes patentees enter into ostensibly "cooperative" agreements, negotiated under threat of patent litigation, which have the effect of extending the duration of their patents and maintaining an artificially high price level for a product line.

Patentees also have refused to share information about unpatented aspects of their products in order to limit competition, which might otherwise produce further innovation that could benefit the public while diminishing the value of the original grant. In a widely noted antitrust enforcement action, for example, the Federal Trade Commission in 1998 charged the Intel Corporation with denying essential technical information and product samples of new microprocessors to companies that, because of intellectual property disputes, had initiated or threatened to initiate litigation against Intel or Intel's customers. Intel's goal, the FTC asserted, was to coerce other companies not to resort to the courts, but instead to license their intellectual property on terms favorable to Intel. The Commission alleged that anti-competitive



effects included discouraging innovation efforts by potential challengers in microprocessor technology. (Pitofsky, 2001).

CONSTRAINTS ON THE ARTICULATION OF CONSUMER INTERESTS

As stated earlier, there is a burden on the applicant for a patent to establish several elements, including originality and usefulness, to receive a patent. For good reasons, there is no requirement for the applicant to prove that an invention will advance the consumer interest. And yet is hard for the authors to see why the process cannot be designed systematically to incorporate greater consideration of consumer concerns:

• Consider a hypothetical decision to grant a patent for the successful invention of a sterile, disease-resistant plant. Foreseeable gains in utility for some agricultural producers and suppliers would result from patenting such an invention, and these will be highlighted by the party seeking the patent in the course of demonstrating suitability for an award—but matters of great concern such as the likelihood of higher prices, or of reduced quantities available for consumption, may be detrimental and yet in the current process are likely to remain undisclosed or underdisclosed. While patent examiners have considerable authority to request information regarding a patent, the proceeding is typically a non-adversarial administrative procedure, where the opportunity for consumer participation in the process is absent. (Oczek).

• Consider a hypothetical decision to grant a patent to a pharmaceutical company for a new drug, which predominantly is the result of a governmental research program, in which the company cooperated but did not participate in actively. The grant of the patent to the company would further the government's interest in promoting the future partnering with the drug industry; but the resulting monopoly on production would dramatically increase the cost of the drug and the value to consumers will be attenuated at best. Consumers generally do not have standing to challenge the award of a patent. (Naik, Davis).

• Consider the fact that there is no doctrine of "fair use" in patent law comparable to the doctrine in copyright law, which allows limited use of material to further the development of new ideas which make unsubstantial use of patented processes. (O'Rourke).

• Finally, consider the potential value of allowing consumers or agencies representing them to challenge patent holders for failing to develop or license their patents at reasonable cost—a right which has been narrowed by case law and is nonexistent for consumers. (Naik, Davis).

CONCLUSION

The old saying that war is too important to be left to generals can be applied to patent law, which has too profound an impact on consumers to be only the domain of patent law specialists. Redrawing some of the rules, notably the basic protection period which has been set to harmonize with global standards, now appears to be "off the table." If consumer groups and consumer educators will more systematically address the specific problems involved, however, the current lines between patent monopoly power and competition may be redrawn.

The authors hope that this discussion

stimulates further research by consumer affairs professionals into methods for improving the responsiveness of the system of patent and intellectual property protection to consumer interests.

ENDNOTE

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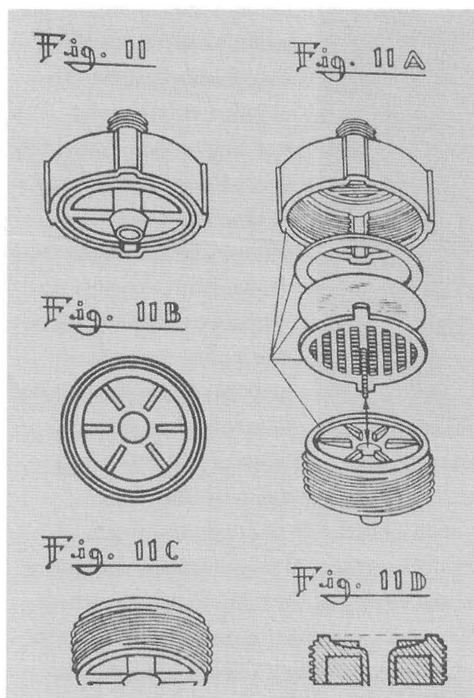

Increasing Participation in Mainstream Financial Markets by Black Households

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Federal Reserve Bank of Chicago

INTRODUCTION

A relationship with a formal financial institution offers many benefits to the consumer. This paper summarizes the findings from a unique survey of Black households designed to obtain a better understanding of these consumers' needs for and availability of credit and financial services. Based on the facts drawn from this survey, we propose specific ways that policy makers can help increase participation in mainstream financial markets and assist minority consumers in making informed financial decisions.

The availability of credit and financial services is essential to consumers and promotes vitality in the communities in which they live. Consumers gain numerous advantages from holding a deposit account and establishing a credit relationship with a formal financial institution. For example, the cost to consumers in making financial payments through a deposit account is often less, both in terms of time and actual expense. In addition, by placing liquid assets in a deposit account, consumers are shielded against risks associated with holding uninsured cash reserves. A deposit account can also be a useful tool used to manage more effectively personal finances and can provide a financial cushion against unforeseen events. By having a deposit relationship with a financial institution, the consumer has greater access to credit and can more easily purchase or refinance a home. As a homeowner, the consumer can build equity and wealth while enhancing neighborhood stability and growth.

Ultimately, a household's participation in mainstream financial markets sets into motion at least 20 consumer protection laws and regulations to help ensure that individuals are safeguarded from unfair, discriminatory, or predatory lending practices.

Despite these advantages, roughly 10 million households in the U.S. are unbanked. Over 57 percent of the unbanked are in

minority households. As a racial/ethnic group nationwide, Black households rank highest among the unbanked, with 37 percent of these households without either a checking or savings account. Lower-income households, especially those located in urban areas, are likely to have easy access to check-cashing outlets (e.g., currency exchanges), short-term lenders (e.g., payday and title loan companies), or pawnshops to meet their financial transactions needs. Studies have shown that these consumers pay considerably more for financial services (Consumer Federation of America, 1997). It is often claimed by consumer advocacy groups and community organizations that unbanked consumers are vulnerable to market exploitation because of a lack of sufficient competition in the supply of alternative sources of financial services. Whether this is true continues to be heavily debated.

Bond and Townsend (1996) have shown that informal financial markets are a viable, but often less documented, source of financing for minorities. Informal financial markets are comprised of networks of family, friends and social organizations that provide credit and other financial assistance at a lower cost with greater flexibility than that provided by formal financial markets. The degree by which minority consumers, especially Black households, utilize informal financial markets needs to be better understood.

The Federal Reserve Bank of Chicago sponsored a survey in Chatham, a predominantly Black community on the south side of the City of Chicago, to gain a better understanding of the Black household's need for and availability of credit and financial services. Based on the facts drawn from this survey, we propose specific ways that policy makers can help increase participation in mainstream financial markets and assist minority consumers in making informed financial decisions.

SURVEY DESCRIPTION AND HOUSEHOLD CHARACTERISTICS

For the nation, almost 60 percent of all Black households reside in urban areas. As such, the urban community of Chatham is of particular interest because of its distinct and long-standing racial/ethnic heritage. According to the U.S. Bureau of the Census, Chatham is a middle-income community with a population of approximately 39,280. Median family income is $35,000, 13 percent higher than the estimated median family income of $30,959 for the City of Chicago. Chatham's homeownership rate is comparable to that for Black families nationwide (roughly 40 percent). The housing stock in this community is comprised primarily of single-family and two- and three-flat apartment buildings. The survey instrument used in our study was adapted from a survey funded by the Center for the Study of Urban Inequality at the University of Chicago.[2] The household survey universe was constructed by using a multi-stage full probability sample model based on the U.S. Census block groups for this community. In 1996, field staff held face-to-face interviews that resulted in 194 randomly selected households completing the survey (with a response rate of 64 percent).[3]

The household's link to the formal financial market was captured through information collected about their use of deposit accounts and holdings of credit products including mortgage-related loans and consumer debt. The survey also has detailed questions related to the household's use of informal financing sources and patronage of check-cashing outlets (known as *currency exchanges* in the Chicago metropolitan area and the rest of the state of Illinois). Selected sample characteristics are provided in Table 1, Column 1.

USE OF DEPOSIT ACCOUNTS AND CREDIT PRODUCTS

In this middle-income community, we found that one out of every five households were unbanked (Column 3). Consistent with previous studies, a higher proportion of unbanked households had lower income and tended to be less educated, younger, female and unmarried (Hogarth and O'Donnell, 1997; Caskey, 1997; U.S. Department of the Treasury, 1997).

Close to 30 percent of the Chatham

"In this middle-income community, we found that one out of every five households was unbanked."

households surveyed experienced a financial setback (e.g., loss of employment and unusually low income) during the five years prior to the survey (Rhine and Toussaint-Comeau, 1999). The most frequent response made by these households was the liquidation of existing assets such as savings and checking accounts. Clearly, these consumers benefited from using these deposit accounts as a financial cushion when unforeseen events occurred. Forty-nine percent of respondents had a credit card. The average credit balance was $1,434, somewhat less than the $1,700 balance reported among families nationwide (1995 Survey of Consumer Finances (SCF)). Twenty-two percent reported having major household debt, averaging $47,313. The most common source of debt was installment borrowing at 44 percent, which included vehicle payments, student loans and furniture payments. Other sources included home-secured debt at 23 percent, credit card debt at 19 percent, and miscellaneous debt, such as utility payments outstanding at 14 percent. For families nationwide, home-secured debt was the main source of indebtedness, accounting for almost 76 percent of all debt (1995, SCF). By comparison, home-secured debt in Chatham was rather modest. The debt-to-income ratio was 34 percent, compared to 55 percent for all U.S. families (1995, SCF).

"Consumers benefitted from using their deposit accounts as a financial cushion when unforseen events occured."

Consistent with the relatively low debt for households in this community, respondents reported moderate use of home-related loans over the previous five-year period prior to the survey. Nine percent had a home mortgage or refinance loan, 6 percent received a home equity loan and 3 percent obtained a home expansion loan. The most frequently reported loan was for vehicles (33 percent of households), which was similar to the 31 percent reported for all U. S. families (1995, SCF). The relatively modest mortgage-related lending and home-secured debt observed may have been a result of dampened demand for mortgage lending due, in part, to the relatively older population. As shown in Column 1, 23 percent of the households were retired, which is about twice the percentage of retired households at the state or national level. Alternatively, some of these consumers also may have experienced difficulty in obtaining credit either because of uncertain credit worthiness and/or credit barriers. Fully accessing the housing market activity (*i.e.*, housing demand and supply) and credit availability in this and other minority communities, while beyond the scope of this study's focus, deserves further attention.

USE OF ALTERNATIVE FINANCIAL SERVICES

Column 4 reports that over 75 percent of the Chatham households surveyed (148 of 194) patronized AFS businesses (currency exchanges). A comparison of banked and unbanked AFS users shows that a higher proportion of the unbanked had lower income and less education. They also tended to be more heavily represented among the unemployed and those receiving public assistance. Interestingly, 74 percent of AFS user households (Column 6) were banked, suggesting that AFS use is not confined to unbanked households. Whether households obtained financial and/or non-financial services from currency exchange businesses could not be determined from the data. This prompted a further investigation by Rhine *et al* (2001), who found that, in the Chicago metropolitan area, the use of financial services (e.g., cashing checks or purchasing money orders) from currency exchanges is dominated by unbanked consumers, minorities, and consumers residing in lower-income neighborhoods.[4]

USE OF INFORMAL FINANCIAL NETWORKS

Lower-income households in need of small dollar loans or gifts most frequently sought assistance from informal networks (Rhine and Toussaint-Comeau, 1999). These networks were primarily used to either help finance a home or to cope with a financial setback. For example, over 21 percent of the homeowners (18 of 84) obtained financial assistance from family, friends, or ethnic/community organizations when purchasing their home. In addition, almost 29 percent of the households who experienced a

financial setback over the previous five-year period (16 of 56) gained assistance from informal financial markets. These findings suggest that informal markets may be especially important funding sources.

POLICY IMPLICATIONS SUGGESTED BY THESE FINDINGS

Our study finds that Black households that are unbanked and AFS users tended to have lower income and were less educated, younger, and unmarried. These consumers are unable to take advantage of the numerous benefits offered from a relationship with a financial institution and are less likely to have the needed cushion against unforeseen events. We also observed modest mortgage-related credit activity and found that informal networks played a role in the home purchase process and in coping with financial distress. Although specific to the Chatham community, these facts offer useful insights about particular ways that policy makers can help increase participation in mainstream financial markets and assist minority consumers in making informed financial decisions. From a policy perspective, we suggest that consumer education, relationship building, and implementation of specific consumer laws and regulations play a key role in this process.

CONSUMER EDUCATION

Consumer education programs that explain the substantial benefits from having an established relationship with formal financial markets should be targeted especially to unbanked and AFS-user minority consumers. Topics of particular usefulness to these consumers are: maintaining a household budget, managing a checking and savings account, assessing the costs and benefits of using deposit accounts relative to alternative financial services, establishing and maintaining good credit, and financing options in the purchase of a home.

Community centers, block clubs and church organizations can be an effective vehicle to bring educational programs to their communities and to encourage resident participation. These community-based organizations also can leverage resources by establishing partnerships with financial institutions, consumer counseling organizations, educational institutions, and government-sponsored programs to help bring these programs to their neighborhoods.

The efficacy of consumer education and financial literacy programs will likely depend on the delivery method used. To better gauge how these programs might be more effectively delivered to consumers, the Federal Reserve Bank of Chicago held focus groups attended by more than 20 local community leaders (Toussaint-Comeau and Rhine, 2000). Several recurring themes were identified by these focus groups. In particular, using radio and television media are an effective way to provide information to consumers but are expensive delivery mechanisms. Information offered through a web site might be less effective for lower-income individuals if they do not have convenient access to the Internet. Consumers are more receptive to informal seminars held in their community. Resource materials such as pamphlets, booklets and videos are more useful to consumers when disseminated at these informal programs. Finally, consumer education should be targeted to students at an early age.[5]

"Black households that are unbanked... tended to have lower income and were less educated, younger and unmarried."

RELATIONSHIP BUILDING

For generations many Black families have been distrustful or wary of formal financial institutions because of negative historical experiences and/or perceptions. Lack of confidence in these institutions has likely contributed to the number of Black households who are inexperienced with formal financial markets. This may partly explain the modest use of mortgage-related credit and the tendency to use informal networks among Chatham households. To more effectively serve minority customers, financial institutions can actively participate in educational and outreach programs by establishing partnerships with community-based organizations and agencies that work directly with these consumers. To help educate minority consumers about the products and services

available, financial institutions can launch marketing and multimedia advertising campaigns targeted to these consumers. Moreover, a culturally diverse financial institution may be better able to attract and serve minority consumers residing in their market area. By fostering a solid relationship with minority consumers, financial institutions can benefit from tapping into this growing demographic group.

SELECTED CHATHAM HOUSEHOLD CHARACTERISTICS

	Total Sample (1)	Banked (2)	Unbanked (3)	AFS Users Total (4)	AFS Users Unbanked (5)	AFS Users Banked (6)
Total	100	79	21	100	26	74
	PERCENTAGES					
GENDER						
Male	37	39	29	37	32	39
Female	63	61	71	63	68	61
MARITAL STATUS						
Married	37	39	27	36	29	39
Not married	63	61	73	64	71	61
AGE						
18-34	20	18	27	22	29	30
35-59	51	51	49	56	53	57
60 and higher	29	31	24	22	18	23
EDUCATION						
Less than HS	11	6	29	13	32	6
HS or equivalent	30	29	34	31	36	30
College and Above	59	65	37	50	32	64
HOUSEHOLD INCOME[1]						
1st Quarter	20	17	50	28	50	21
2nd Quarter	20	26	22	25	20	26
3rd Quarter	20	26	19	21	20	22
4th Quarter	20	30	9	30	10	31
Public Assistance	11	6	29	14	29	8
EMPLOYMENT STATUS						
Employed	62	66	46	66	50	72
Retires	23	26	29	20	24	19
Other/Not Employed	10	5	7	5	8	5
Unemployed	5	3	15	7	16	4
ASSETS						
Home/land/property	45	54	15	37	11	46
Vehicle	65	75	32	64	34	75
DEBTS						
Credit Card	49	59	10	43	11	55

[1]Chatham's median household income was $35,000, while the average household income was $37,726.

PUBLIC POLICIES TO ASSIST LOW-INCOME CONSUMERS

The Community Reinvestment Act of 1977 (CRA) encourages financial institutions to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the institution's safe and sound banking practices. There are a number of ways that financial institutions can help meet the credit and financial service needs of lower-income communities, while promoting community development and encouraging consumers' participation in mainstream financial markets.[6] For example, financial institutions can make loans or investments in financial intermediaries, which includes community development corporations (CDCs) or community development financial institutions (CDFIs) that provide lending to low- and moderate-income individuals; provide credit counseling and other financial services such as low-cost checking; and use of flexible underwriting approaches to facilitate lending to low- and moderate-income consumers, consistent with safe and sound lending practices.[7] As an additional option, community-based organizations can take advantage of informal network attributes by creating programs such as micro-lending associations and investment clubs to help meet short-term liquidity needs of consumers.

Public policies that promote greater savings and low-cost deposit accounts also are important ways to help consumers meet their financial needs. For example, the Debt Collection Improvement Act of 1996 encourages banks to offer low-cost deposit accounts, including electronic transfer accounts or free government check-cashing services, to help increase access of financial services to lower-income individuals. The SAVER Act of 1997 has advanced the public's knowledge about the importance of savings by establishing an ongoing educational program. A five-year demonstration project to determine the effectiveness of policies to help the poor accumulate assets was initiated through the Assets for Independence Act of 1998.

Our study affirms the importance of these types of regulatory policies to enhance credit availability, encourage savings, and increase the use of mainstream financial services among low-income and minority consumers.

ENDNOTES

[1]Maude Toussaint-Comeau works as Economist in the Consumer and Community Affairs division at the Federal Reserve Bank of Chicago. Sherrie L.W. Rhine is Manager and Senior Economist, in the Consumer and Community Affairs division at the Federal Reserve Bank of Chicago. The opinions expressed in this study are the authors' and do not necessarily represent the opinions of the Federal Reserve Bank of Chicago or the Federal Reserve System. The authors would like to thank the anonymous referees for their helpful comments and suggestions in an earlier draft of this paper. Address correspondence concerning this manuscript to the authors at the Federal Reserve Bank of Chicago, Consumer and Community Affairs Division, 230 South LaSalle, Chicago, Illinois 60604.

[2]The original survey instrument was developed for a study conducted in Little Village, a predominantly Hispanic community situated on the southwest side of the City of Chicago. Richard Taub, Marta Tienda, and Robert Townsend were the principal investigators, Bond and Townsend (1996).

[3]The Chatham research project also included a random survey of small business owners. See Huck et al., (1999).

[4]The data source was the 2000 Metro Chicago Information Center annual survey of approximately 3,000 households in the Chicago six-county metropolitan area.

[5]Information about nationwide financial literacy and consumer education programs is provided at www.chicagofed.org/cedric.

[6]For a listing of eligible loans, investment, and services that financial institutions can do to help meet some of their CRA requirements, see the FFIEC (1999).

[7]See Rhine (1997) for examples of creative and flexible mortgage products offered by three partnerships in the Chicago metropolitan areas.

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Consumer Credit Counseling Services: the Need for Reform and Some Proposals for Change

Stephen Gardner[1]

Consumers with debt problems often find themselves directed to credit counseling services organizations for advice and assistance in arranging payment plans with their creditors. There are well over 2,300 of these organizations in this country.[2] In 1996 alone, over 1.5 Million people sought counseling from these organizations.[3] These organizations use a variety of names, but are all in the business of consumer credit counseling, so this article will use the generic term "CCCS organizations" to refer to the entire industry. For similar reasons, this article will refer to consumers who seek the help of CCCS organizations as "consumers" and not "debtors."

Although CCCS organizations can and do provide much-needed advice and assistance to consumers, there are also concerns from a consumer advocacy standpoint with many of the practices and policies of CCCS organizations in this country.[4] The concerns discussed in this article are common to many, but by no means all, of those organizations that are in the business of consumer credit counseling.

These concerns will become significantly more pressing if Congress passes proposed amendments to the Bankruptcy Code that will force consumers to obtain the services of a CCCS organization prior to proceeding with a bankruptcy.

Therefore, following a description of the concerns of consumer advocates, this article concludes with recommendations for change, to insure that consumers are not misled by the very CCCS organization to which they gave their trust.

DEBT COUNSELING—GENERAL CONSIDERATIONS

In most instances, a person who has debt problems has gotten into that situation involuntarily, due to job loss, high medical expenses, or other matters that are beyond the control of the consumer. In virtually every instance, regardless of the reason for the debt problems, the consumer wishes to pay off all debts as soon as possible. In other words, people who wittingly incur debt without the intent of paying it off are few and far between.

Most people with debt problems, and most people who seek the services of a CCCS organization, have low to moderate incomes. Quite often, their monthly debt load exceeds their monthly income from all sources. The correct advice to give a person with debt problems varies in each case. However, any-

one with debt problems must at a minimum consider several options.

The first option that must be considered is filing for bankruptcy court protection, either in a standard Chapter 7 bankruptcy or under a Chapter 13 Wage Earner plan. Although many or most people with debt problems do not need to take the drastic step of filing for bankruptcy, it must always be part of the mix when counseling a consumer about dealing with debt problems.

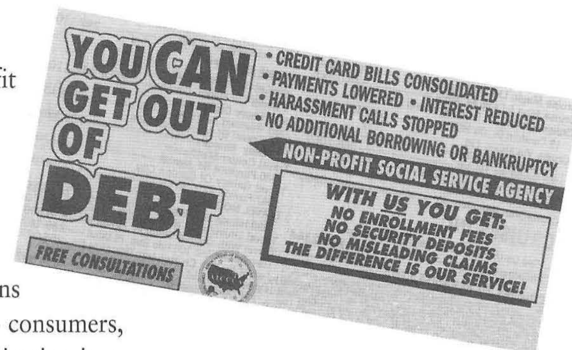
A second option that the consumer must consider and decide is whether to pay some creditors in full immediately, pay some creditors over time (either in full or in a negotiated reduced amount), and pay some creditors nothing whatsoever.

First priority must be given to the necessaries of life—shelter, transportation, and food. For this reason, it is usually essential to insure that payments required to maintain these necessaries are made timely and in full, even if that means that some creditors are not paid at all for several months.

In addition, in our society, a credit card is a near-essential. It is virtually impossible, for instance, to rent a car without a major credit card. Many retailers require a person to show a credit card as identification in addition to a driver's license, just to pay by check. Therefore, in most instances, it is in the consumer's best interest to insure that at least one credit card remains in good standing. In order to achieve these goals, it may be necessary to remain in complete default on other debts, particularly other credit card debt that is unsecured.

THE DECEPTIVE NATURE OF CCCS ORGANIZATIONS

At their inception, CCCS organizations were generally "financed and sponsored by creditor organizations."[5] Nonetheless, CCCS organizations have from the start represented to consumers that they offer credit counseling services, and that they are available to assist and advise consumers as to the best steps they can take to resolve their debt problems. In truth, but unknown to virtually all consumers, CCCS organizations provide debt collection services to various creditors, assisting them in collecting debts from the consumers who seek their assistance. Although CCCS organizations also provide limited credit or debt counseling to these consumers, the primary role is as a debt collector. At least one court has correctly recognized that CCCS organizations are fundamentally "collection agencies."[6] Similarly, one commentator says that CCCS organizations serve "the now familiar creditors' needs of establishing the probable benefit of a concerted extension plan and monitoring both the debtors' and each creditor's adherence to that plan once it is in place."[7]



Although CCCS organizations prefer to stress their services to consumers, the actions of one CCCS organization in a bankruptcy court illustrate their true colors. The CCCS organization collected money in trust from a consumer, named Logan, to be distributed to various creditors. However, before the money could be distributed, the consumer filed for bankruptcy protection. The court-appointed bankruptcy trustee sought to bring the money held by the CCCS organization into the bankruptcy property, so that it could be used to pay creditors in accordance with federal bankruptcy rules. The CCCS organization, however, resisted strongly and refused to allow the consumer or the trustee to reclaim the money.[8] Forced to choose, the CCCS organization chose to benefit some creditors (and itself, since it presumably took its fee) rather than the consumer.

This is not an isolated instance. It is the set policy of some CCCS organizations that they never refer debtors to bankruptcy.[9] In the author's opinion, this demonstrates clearly that a CCCS organization is in the business of helping the creditors for whom it performs debt collection services, and not the consumer.

In many instances, CCCS organizations do not adequately disclose the collection agency role to consumers who seek and obtain counseling from it. Because the primary goal of a CCCS organization is to assist creditors in collecting debt and because CCCS organi-

zations do not disclose this goal to consumers, many CCCS organizations are not engaged in bona fide consumer credit counseling. Their activities fall within both state and federal debt collection acts.

In addition, CCCS organizations often fail to disclose to consumers that they make money based on how much they persuade consumers to pay on their debts. CCCS organizations call this a "fair share" contribution. A more honest description is "kickback," and this article uses that term.
The standard kickback obtained by CCCS organizations is 15% of the amount collected. In 1998, the CCCS organizations affiliated with the National Foundation for Consumer Credit (about two-thirds of the total number of CCCS organizations in the country) returned approximately $1.9 Billion to creditors.[10]

"In many instances CCCS organizations do not disclose the collection agency role to consumers."

Assuming, very conservatively, that these organizations only got the 15% kickback for half that amount, this means that for one year along, just one segment of the credit counseling industry retained $140 Million in profits. This is big business. And the problem is not that they make this much money. The problem is that CCCS organizations, by and large, don't tell the debtor that they will make money off them.

Training materials of CCCS organizations, as well as their television commercials and other promotional materials, illustrate the problem. Television commercials often fail to disclose the dual role played by CCCS organizations—debt collection for creditors and some debt counseling for consumers—nor do commercials generally disclose the kickbacks a CCCS organization will receive.

It would be one thing for CCCS organizations to operate as they do while disclosing to consumers who seek its counseling that they do not act solely in their interests, but rather and primarily in the best interest of the creditor companies that make their existence possible. But few CCCS organizations provide this information to consumers in a meaningful manner. Without this very material information, it is impossible for consumers to make an informed choice about whether to follow the recommendations of CCCS organization.

Written promotional materials may contain the meaningless statement that a CCCS organization is "supported" by creditors, or similar language. A consumer is more likely to understand this to mean that creditors cooperate with CCCS organizations (and thus "support" their activities) than the truth that the CCCS organization performs debt collection and gets a kickback when it succeeds in persuading a consumer to establish a payment plan.[11]

Even disclosures which are supposedly better may not do an effective job of telling the truth to a consumer desperate for help. For example, one CCCS organization offered a supposed "disclosure" that represents that the CCCS organization requested a "tax-deductible" payment from creditors. This makes it appear that the work a CCCS organization does is charitable in nature. In truth, the likely reason such payment is tax deductible is that it is a business expense for debt collection, not because it is a charitable contribution. Thus, this disclosure does not inform consumers of the dual role and the kickback in a meaningful manner.

For these reasons, in the author's view, at the current time, the bulk of CCCS organizations operate deceptively. Their objectionable conduct does not stop there, however, as discussed in the following sections.

BREACH OF FIDUCIARY DUTIES

The relationship between a CCCS organization and any consumer who seeks counseling from a CCCS organization is fiduciary in nature, except in unusual circumstances. Virtually all CCCS organizations train their counselors to seek to establish a confidential and trusting relationship with consumers. Considered as fiduciaries, CCCS organizations frequently fail to meet their duties to consumers.

In addition to failing to disclose information concerning their relationships with creditors to consumers as indicated above, CCCS organizations also engage in a related practice that is very harmful. They frequently fail to account to consumers for monies received from them and disbursed to creditors, because they falsely claim in the monthly

statements they provide to consumers that all monies paid to them were disbursed, when in fact a significant percentage of the amount received was retained by the CCCS organization itself. And further, the monthly statements generated are often silent on disposition of interest earned on these payments. Surely the consumers have not, in most cases, received the interest. It may be presumed that in most instances CCCS organizations keep the interest, and remain silent.

To the extent this conduct takes place it is a breach of a CCCS organization's fiduciary duties to consumers, as well as being a deceptive practice. Reform is necessary.

PROBLEMS WITH THE SUBSTANCE OF CCCS ORGANIZATION ADVICE

Beyond their breaches of their fiduciary duties to consumers and regardless of their failures to disclose their dual nature and the kickbacks they receive, CCCS organizations often give improper advice to a consumer with debt problems, to the direct benefit of some creditors.

It is the standard practice of many CCCS organizations to refuse to discuss bankruptcy in the context of counseling a consumer.[12] As discussed above, bankruptcy is an option that must be considered by anyone whose debt problems are serious enough to warrant counseling by a CCCS organization or anyone else. In fact, CCCS organizations have marketed their services to creditors based in significant part on positioning themselves as an alternative to bankruptcy.

It is the standard practice of many CCCS organizations to require consumers to agree to pay all creditors.[13] As discussed above, it may be necessary for a consumer to pay some creditors in full immediately, to pay some creditors over time, and to pay some creditors nothing whatsoever.

It is the standard practice of many CCCS organizations to require consumers to surrender all of their credit cards and to cut them up.[14] While this may be the best result for some consumers, and while it is unquestionably good drama, it is against the interests of many, and probably most, consumers. As discussed above, in most instances, it is in the consumer's best interest to insure that at least one credit card remains in good standing.

These standard practices prevent the counseling and advice to consumers from being complete and appropriate. These standard practices have the tendency and capacity to deceive consumers into believing that these actions are in their best interest, when it often is not.

These practices of CCCS organizations are due, at least in part, to the simple fact that CCCS organizations primarily represent the interests of all creditors and cannot play favorites with one over another. In addition, bankruptcy is generally never in the interest of a creditor. Because creditors are the ones buttering the CCCS organizations' bread, it is unlikely that a CCCS organization will ever objectively advise a consumer about bankruptcy.

This very inadequate advice demonstrates the conflict of interest between acting as a collection agency (and getting paid for it) and giving out credit counseling to consumers (and getting paid nothing). This dual role of a CCCS organization is inherently a problem, and will remain a problem as long as CCCS organizations insist on presenting themselves as the consumer's friend.

FTC INVESTIGATION OF THE NATIONAL FOUNDATION FOR CONSUMER CREDIT

The Federal Trade Commission ("FTC") has investigated the practices of some CCCS organizations. In 1996, a lawyer for the National Foundation for Consumer Credit ("NFCC"), an organization comprised primarily of CCCS organizations, advised the FTC that NFCC was considering a policy that would require all CCCS organizations affiliated with NFCC to "provide a uniform and pertinent disclosure *in all appropriate communications* with consumers in order *to fully inform consumers about the relationship between NFCC members and creditors*. This policy would *assist consumers in making a meaningful choice* between various alternatives to CCCS organizations, including self-help,

"Considered as fiduciaries, CCCS organizations fail to meet their duties..."

other credit counselors, legal assistance and bankruptcy."[15] [Italics added.]

The disclosure stated that most funding for CCCS organizations affiliated with NFCC came from creditor payments, calculated as a percentage (up to 15%) of the payments the consumers made in repayment plans set up by CCCS organizations. The disclosure also described the dual role played by CCCS organizations. This disclosure was to be included in all brochures and other promotional materials, on any worksheets or other agreements filled out or signed by the consumer, and in response to any inquiry from a consumer as to how a CCCS organization was funded.[16]

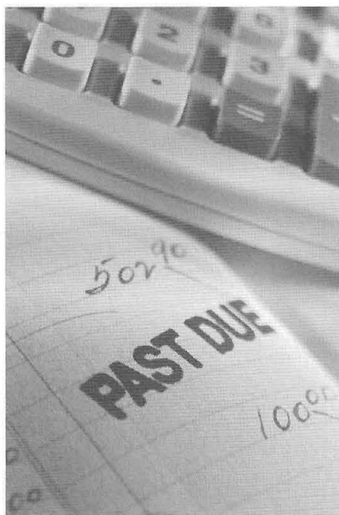
In a subsequent letter, the NFCC lawyer advised the FTC that NFCC had drafted final language for adoption and provided the actual policy.[17] On March 17, 1997, the FTC issued a press release that announced that the disclosure policy resolved the FTC staff's concerns about the practices of CCCS organization entities.[18] The effective date of this disclosure policy was June 1, 1997.[19]

Although NFCC should be congratulated for attempting self regulation, but this effort does not cure the problems set forth above, for two reasons. First, and foremost, when this disclosure is received and understood by the consumer, it only alleviates the consumer confusion caused by the deceptive nature of a CCCS organization's work. It does not address the other problems—the substantively bad advice most importantly. It merely insures, at best, that the consumer understands that he is dealing with a collection agency, albeit a kinder and gentler one than usual.

Second, even this minimal disclosure was not being used by all CCCS organizations several years after the supposed June 1997 effective date. To the extent that it exists in a vacuum at the FTC, it does no good at all.

Therefore, more far-reaching reforms to the practices of CCCS organizations are necessary.

"A number of simple steps can ensure that the consumer who elects to use the services of a CCCS organization does so with full knowledge of the truth."



PROPOSALS FOR CHANGE

A number of simple steps can ensure that the consumer who elects to use the services of a CCCS organization does so with full knowledge of the truth.

It is essential that the consumer be aware of the dual nature and the kickback before making his or her first appointment and at all other relevant times. If not, this will be a simple case of bait and switch. It is not sufficient to tell the truth to a consumer only after luring him or her into the place of business. The truth can be told simply, by following these practices:

- All brochures and all other advertisements and commercials must describe the dual role and the kickback.
- At the time of his or her initial contact, the consumer must be orally told the dual role and the kickback, whether the contact is on the phone or in person.
- Prior to the initial counseling session and again before entering into any repayment plan, the consumer must have the dual role and the kickback explained to him or her in an understandable and meaningful fashion. This should be done both orally and in a clear, written form that the consumer signs and keeps. These disclosures must be made in any agreement or other form that the consumer fills out or signs.
- When it comes to consumer counseling, no one size fits all. That is, what may be excellent advice for one consumer may be terrible advice for the next one through the door. Therefore, CCCS organizations must abandon their doctrinaire policies that uniformly favor the interests of creditors and often hurt consumers.

In specific, the following steps are necessary:

- Consumers seeking debt counseling should be offered information about the availability of options in bankruptcy.
- Consumers who enter into payment plans with a CCCS organization should not be forced to make payments to all creditors. Payments to utility companies, for example, should be given greater priority to be paid in full than payments to unsecured creditors.
- Consumers who enter into payment plans with a CCCS organization should be

encouraged to retain at least one active credit card and to keep it in good standing, even if it means paying that creditor disproportionately.

- In every monthly statement provided to consumers who establish a payment plan, CCCS organization must disclose the amount of kickback it has retained from the consumer's payments to it and the amount of any interest earned on the consumer's funds that it retains or otherwise does not return to the consumer.

Consumers come to CCCS organizations for help and rely on the relationship of trust that a CCCS organization strives to establish. They are likely to be in emotional distress. They are not likely to comprehend or remember a single oral disclosure. For similar reasons, a sole instance of written disclosure is not enough, because consumers are unlikely to notice or appreciate the import of the disclosure. Thus, it is essential that all of the bulleted steps, or similar ones, be taken. It is possible to insure consumer understanding without taking the bulleted steps in the same order set forth above. There are possible variants that will also be successful. But it is a certainty that the current practices of many CCCS organizations are not enough.

Unless a consumer knows the true relationship between CCCS organizations and creditors and the direct financial incentives a CCCS organization has to increase the size of the monthly payments made by consumers, the consumer will make a decision to use a CCCS organization without adequate facts. In market terms, this is a bad purchasing decision.

SUMMARY AND CONCLUSION

For all the reasons set forth above, the current state of CCCS organization advice and counseling to consumers is deceptive and fundamentally corrupted by their primary duties as collection agencies for creditors. This inherent conflict of interest is fatal to any honest claim by a CCCS organization to be acting for the consumer's interest.

However, a CCCS organization can provide limited services to consumers, if its true motivations are understood by consumers at the outset and if its advice is not slanted to favor creditors. The consumer must be equipped with the truth—both about the nature of a CCCS organization and the various options available to debtors—in order to make an informed choice about the CCCS organization and about her own future credit decisions.

ENDNOTES

[1] Stephen Gardner has been a consumer advocate and lawyer for 25 years. During that time, he served as an Assistant Attorney General in Texas and New York, the Students' Attorney at the University of Texas at Austin, and a legal services attorney. He has previously testified against CCCS practices. He is principal in the Law Office of Stephen Gardner, PC, in Dallas, Texas.

[2] David A. Lander, A Snapshot of Two Systems That Are Trying to Help People in Financial Trouble, 7 Am. Bankr. Inst. L. Rev. 161, 176 (Spring 1999) [cited herein as "Lander."}

[3] Lander, at 175.

[4] The author developed the opinions expressed in this article over the course of 25 years as a consumer advocate. Some of the language in the article is taken from his testimony as an expert witness in a private class action filed in Dallas against several local consumer credit counseling services. However, the opinions expressed in this article are general in nature and do not apply to any specific CCCS organization.

[5] Carl Felsenfeld, Consumer Credit Counseling , 26 Bus.Law 925, 929-30 (1971).

[6] Knutsen v. Consumer Credit Counseling Service of Minnesota, Inc., 1999 U.S. Dist. LEXIS 16056, *7 (D. Minn. 1999).

[7] Winton E. Williams, Games Creditors Play: Collecting from Overextended Consumers at 116 (Carolina Academic Press 1998).

[8] Logan, Chapter 7 Trustee, v. Consumer Credit Counseling Service of Central Ohio, Inc., 126 B.R. 978, 1991 Bankr. LEXIS 624 (S.D. Ohio 1991).

[9] Lander, at 177.

[10] Lander, at 179.

[11] Tahira K. Hira and Kyle L. Kostelecky, "Pilot Study of Consumer Debtors Provides New Insights—What Influences Debtors' Attitudes?" 1999 American Bankruptcy Institute American Bankruptcy Institute Law Review (Spring, 1999).

[12] Lander, at 177.

[13] Lander, at 178.

[14] Lander, at 179.

[15] July 23, 1996 letter from Vincent M. Amberly to the FTC. This letter
and other FTC-related materials are available at www.ftc.gov/os/1997/9703/index.htm#March 17, 1997.

[16] July 23, 1996 letter from Vincent M. Amberly to the FTC.

[17] February 27, 1997 letter from Vincent M. Amberly to the FTC.

[18] FTC March 17, 1997, Press Release.

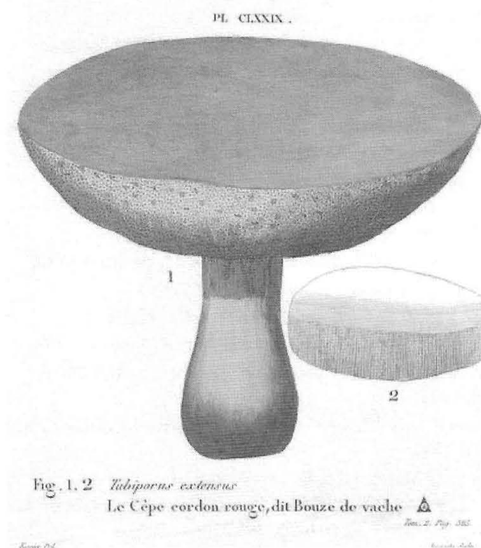
[19] February 27, 1997 letter from Vincent M. Amberly to the FTC; FTC March 20, 1997, Press Release.

Consumer Law: Advances and Setbacks

In the opinion of the editors, the cases digested below "advance" or "set back" the consumer interest. These characterizations reflect opinions of the editors and do not in any way represent policies or positions adopted by ACCI or Advancing the Consumer Interest. Persons with differing viewpoints are encouraged to reply.

SETBACK: REGULATION OF CLAIMS ABOUT MUSHROOMS VIOLATES COMMERCIAL SPEECH RIGHTS

There is (believe it or not) a "Mushroom Promotion, Research, and Consumer Information Act" which mandates that fresh mushroom handlers pay assessments, which are used primarily to fund advertisements that promote mushroom sales. Believing that being compelled to pay for "generic" advertising sent a message contrary to one that



conveyed the superiority of its own mushrooms, United Foods Corporation refused to pay the assessment claiming that it violated its First Amendment rights. United Foods first complained to the Secretary of Agriculture who brought suit to compel the assessments. After its administrative appeals were exhausted, United Foods pursued a review in the district court. The district court upheld the Act based, particularly on a case which determined that the First Amendment was not violated by an agricultural marketing order that required producers of California tree fruit to pay assessments for product advertising, a rule which was part of a larger scheme.

The Sixth Circuit reversed the district court. It held that the California case did not control because the mandated payments in the case of the Mushroom Act were not part of a comprehensive statutory agricultural marketing program. Justice Kennedy, speaking for the U.S. Supreme Court, agreed with the Sixth Circuit that the Act was unconstitutional, in his opinion in United States and Department of Agriculture v. United Foods, Inc., 121 S.Ct. 2334 (2001).

Considered either as noncommercial or commercial speech, Justice Kennedy wrote, the assessments could not be sustained. First Amendment values are at serious risk, he said, if the government can compel a citizen or group of citizens to subsidize speech on the side that it favors. Kennedy could find no principle to distinguish great debates about important causes from minor debates about whether a branded mushroom is better than just any mushroom. Thus, the Court stated,

the Act was not merely an economic regulation but was required to pass First Amendment scrutiny.

Justice Breyer, joined by Justice Ginsburg and partly joined by Justice O'Connor, dissented. The Court, he wrote, "disregards controlling precedent, fails properly to analyze the strength of relevant regulatory and commercial speech interests, and introduces into First Amendment law an unreasoned legal principle that to the development of beneficial forms of economic regulation." In this case the Mushroom Act's goal was to maintain and expand uses for mushrooms. Overcoming "inaccurate consumer perceptions about a product" (such as the assumption that some brands or kinds were safer to eat than others) would bring valuable public benefits, and in the absence of the compelled payments there might be a "free rider" problem because some producers would "take a free ride on the expenditures of others."

The case has cast doubt on the ability of the Agriculture Department and other governmental entities to promote standards and grades through cooperative advertising programs. More fundamentally, it suggests that the line between mere economic regulation, that is generally upheld without severe scrutiny by the court, and commercial speech, to which the Court has been increasingly willing to afford significant First Amendment protection, has been more protectively redrawn. It should be noted, however, that the majority opinion suggested that it might have decided the case differently if there had been evidence that assessments were necessary to make voluntary advertisements "nonmisleading" for consumers.

SETBACK: STATE TOBACCO REGULATIONS PREEMPTED

Responding to public concern about youth smoking, the Attorney General of Massachusetts promulgated comprehensive regulations governing the advertising and sale of cigarettes, smokeless tobacco, and cigars. A group of tobacco manufacturers asserted that the First Amendment and the Supremacy Clause of the Constitution

forbade the new regulations because they wrongly compelled speech and because they were pre-empted by the Federal Cigarette Labeling and Advertising Act (FCLAA), which had legislated mandatory health warnings for cigarette packaging and advertising, and pre-empted similar state regulations at the same time. The district court largely upheld the state's regulations. Among its rulings, the court held that restrictions on the location of advertising were not pre-empted by the FCLAA, and that neither the regulations prohibiting outdoor advertising within 1,000 feet of a school or playground nor the sales practices regulations restricting the location and distribution of tobacco products violated the First Amendment. The First Circuit affirmed the District Court's rulings that the cigarette advertising regulations were not pre-empted by the FCLAA and that the outdoor advertising regulations and the sales practices regulations did not violate the First Amendment under previously articulated standards (especially Central Hudson Gas v. Public Serv. Comm'n of N. Y., 447 U.S. 557), although it reversed the lower court's invalidation of new "point-of-sale" advertising regulations, concluding that the Attorney General was better suited than the courts to determine what restrictions were necessary.

The U.S. Supreme Court, however, reversed the First Circuit, in Lorillard Tobacco Co. v. Thomas F. Reilly, 121 S.Ct. 2404 (2001). Justice O'Connor, speaking for a unanimous Court (there were several concurrences and dissents in part) held that the language of the FCLAA pre-empts Massachusetts' regulations governing outdoor and point-of-sale cigarette advertising.

"Greater state tobacco regulation...faces statutory and constitutional obstacles."

The Court's analysis began with the statute's language and considered its legislative amendments, including a predecessor pre-emption provision and the legislative context in which the current language of preemption was adopted. The original provision simply prohibited any "statement relating to smoking and health ... in the advertising of any cigarettes the packages of which are labeled in conformity with the [Act's] provisions." Without question, the Court found, the current pre-emption provision's plain language was much broader. Rather than preventing only "statements," the amended provision reaches all "requirement[s] or prohibition[s] ... imposed under State law."

Although the former statute reached only statements "in the advertising," the current provision governs "with respect to the advertising or promotion" of cigarettes. At the same time that Congress expanded the pre-emption provision of the law with respect to the States, it enacted another provision prohibiting cigarette advertising in electronic media altogether.

As a policy matter, the Court determined that Congress pre-empted state cigarette advertising regulations like the Attorney General's because they would upset federal legislative choices to require specific warnings and to impose the ban on cigarette advertising in electronic media in order to address concerns about smoking and health. The First Circuit had concentrated on whether the regulations were "with respect to" advertising and promotion, and concluded that they were regulations aimed at "youth" rather than cigarettes. The Supreme Court rejected that view. There is no question, it stated, that the regulations expressly targeted such advertising. Nor did the Court accept a distinction between regulation of advertising content and regulation of geographical location.

The Court decided that the state's ban on all smokeless tobacco products was unconstitutional. The Court used its four-part *Hudson* test for analyzing regulations of commercial speech asking (1) whether the expression is protected by the First Amendment, (2) whether the asserted governmental interest is substantial, (3) whether the regulation directly advances the governmental interest asserted, and (4) whether it is not more extensive than is necessary to serve that interest. Only the last two steps were placed at issue. The fourth step requires a "reasonable fit between the legislature's ends and the means chosen to accomplish those ends, a means narrowly tailored to achieve the desired objective." Under its analysis, the Court held that the outdoor advertising regulations prohibiting smokeless tobacco or cigar advertising within 1,000 feet of a school or playground violated the First Amendment. The "broad sweep" of the law indicated that the Attorney General did not "carefully calculate the costs and benefits associated with the burden on speech imposed." Regulations prohibiting indoor, point-of-sale advertising of smokeless tobacco and cigars lower than 5 feet from the floor of a retail establishment located within 1,000 feet of a school or playground also failed both the third and fourth steps of the Central Hudson analysis.

Although the First Circuit decided that the restriction's burden on speech is very limited, the Supreme Court stated that there is no *de minimis* exception for a speech restriction that lacks sufficient tailoring or justification.

In reaching its decision, however, the Court did suggest that some additional regulations of tobacco might be upheld. Even assuming that tobacco sellers have a speech interest in displaying their products, the Court decided that regulations requiring retailers to place tobacco products behind counters and requiring customers to have contact with a salesperson before they are able to handle the products were held to withstand First Amendment scrutiny. The State demonstrated "a substantial interest in preventing access to tobacco products by minors and has adopted an appropriately narrow means of advancing that interest."

This case demonstrates that greater state tobacco regulation in furtherance of public health concerns will face statutory and constitutional obstacles. While the Court has not

placed insurmountable constitutional barriers before the state legislatures, the problem of federal preemption remains daunting.

SPECIAL SECTION:

CONSUMER RIGHTS UNDER THE FAIR DEBT COLLECTION PRACTICES ACT

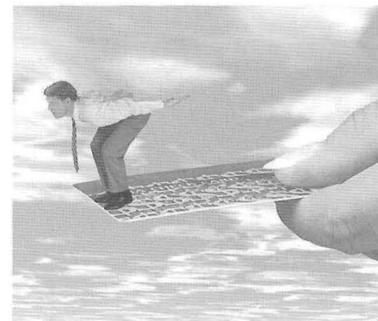
The Fair Debt Collection Practices Act is a federal statute which prohibits debt collectors from engaging in a variety of false, misleading, or deceptive practices. The FDCPA is an important consumer protection statute and will become an even more important subject of litigation in the future because of two recent phenomena. One reason is the impact of welfare reform legislation, which has increased the ranks of the "working poor," people who live paycheck to paycheck and frequently find themselves in debt. The second reason for the growing importance of the FDCPA is the recent enactment of a bankruptcy "reform" law, which significantly restricts the protection afforded to consumers under federal bankruptcy law. As a result, many consumers who previously would have been shielded from debt collection activities by the bankruptcy laws will no longer receive such protection. Courts consequently will be called on with increasing frequency to consider questions stemming from the FDCPA. This section considers a few of those questions, such as the relationship between the FDCPA and state laws, the appropriateness of garnishment procedures under the FDCPA, whether dishonored checks are debts within the FDCPA, and whether debts are designated "consumer" or "business" debts under the statute.

PARTIAL ADVANCE: FDCPA SECTIONS PROHIBITING FALSE OR MISLEADING REPRESENTATIONS IMPOSE STRICT LIABILITY

In January 1998, Andrew Kaplan received medical treatment at Columbia Aventura Hospital in Miami, Florida. At the time, Kaplan had insurance under a HMO health plan through Sunrise Healthcare. Under his policy, all treatments he received were covered by his insurance, and he was responsible only for the payment. Sunrise Healthcare had a billing arrangement with Columbia Aventura, and as a result of the treatments received by Kaplan, Sunrise owed the hospital $4,453.67. Kaplan met his deductible and co-payment obligation under his insurance policy. Nevertheless, on December 9, 1997, Kaplan received a letter from Columbia Aventura attempting to collect the $4,453.67 for medical services that should have been covered by Kaplan's HMO. Columbia Aventura sent the debt to Assetcare, a collection agency, which attempted to collect the alleged debt from Kaplan through a number of letters. Kaplan also received a letter from Equifax attempting to collect the same debt.

As a result of these collection activities, Kaplan filed suit, claiming that the actions of Assetcare and Equifax violated the Florida Insurance Code, which states that a provider of services, or representative of that provider, cannot collect or attempt to collect money from any HMO subscriber for services covered by the HMO. The alleged violation of the Florida Insurance Code was also the basis for Kaplan's claim under the FDCPA that the debt collector's actions were false, deceptive or misleading (i.e., because Kaplan never should have been billed for the healthcare services he received).

The court reasoned that the purpose of the FDCPA is to eliminate abusive debt collection practices and for any violation of the Act, a debt collector may be liable for actual damages sustained by the plaintiff, as well as statutory damages and attorney's fees. The determination of whether a debt collector's practices are false, deceptive or misleading is judged from the perspective of the "least sophisticated consumer." In order for a consumer to prevail under a FDCPA claim, the consumer must prove three things: 1) that they were the object of a collection activity arising from a consumer debt, 2) that the defendant is a debt collector within the meaning of the FDCPA, and 3) that the defendant engaged in acts in violation of the FDCPA. The defendants asserted that Kaplan's claim should be dismissed because



he failed to allege any element of intent on the part of Assetcare and Equifax. The court held that no element of intent is necessary when dealing with a strict liability statute. In the sections of the FDCPA which formed the basis for Kaplan's suit, there is no mention of intent. As a result, knowledge or intent is not a factor in the liability determination.

The federal court refused to consider Kaplan's third claim, which involved interpretation of a Florida insurance statute. Because this was an issue never previously decided by Florida state courts, the federal court held that it should be determined by those courts.

SETBACK: CONSUMERS OF LONG DISTANCE CARRIER SERVICES ARE NOT "CONSUMERS" UNDER FDCPA.

Edward and Eileen Conboy used AT&T as their long distance carrier. During the time the Conboys used AT&T, the company had access to information contained in their billing statements, including their names, their unlisted phone number, their address, and details about their long distance calling patterns. The Conboys never authorized the release of their unlisted telephone number to any other company, and, in fact, paid a monthly charge for it to remain unlisted. At the same time, the Conboys' daughter-in-law, Maria Conboy, held a Mastercard issued by AT&T Universal Card Services ("UCS"), a subsidiary of AT&T. The Conboys had no connection with the credit card or debts owed by Maria. However, in May and June 1998, representatives of UCS called the Conboys at their home phone number between thirty and fifty times seeking information about their daughter-in-law, including her whereabouts. The calls were made repeatedly, and often at strange hours. The Conboys discovered that AT&T had disseminated the information to UCS when one UCS representative informed the Conboys that he knew their unlisted number and information about their long distance carrier.

The Conboys brought a class action suit in federal district court in New York, alleging that by revealing information contained in the long distance bill, AT&T violated the Federal Telecommunications Act, various provisions of New York state law, as well as the FDCPA, specifically provisions related to the use of false, deceptive or misleading representations. The Conboys alleged that AT&T mailed telephone bills to the Conboys for the purposes of gaining information to collect Maria's debt, and there was no language on the bill that indicated that the purpose was to collect a debt. The court in Conboy v. AT&T Corp. and AT&T Universal Card Services, 241 F.3d 242 (2d Cir. 2001), held that the Conboys were not considered consumers under the FDCPA and, therefore, the Act did not apply and the FDCPA claim was dismissed. Under the FDCPA, a consumer is any person obligated or allegedly obligated to pay a debt. Because the Conboys were in no way obligated to pay the debt of their daughter-in-law, they are not considered consumers of UCS. Even though the Conboys are consumers of the AT&T services, they are not considered to be consumers under the FDCPA. The Conboys argued that their civil complaint should be read more broadly to include other possible claims under the FDCPA that can be asserted by a person other than a customer. The court disagreed because the Conboys specifically asserted claims under the false, deceptive or misleading portions of the Act.

ADVANCE: GARNISHMENT OF BANK ACCOUNT WAS UNAUTHORIZED UNDER FDCPA

On April 29, 1997, Eric Picht deposited his paycheck in the personal checking account he shared with his wife, Shayleen. Between that date and May 7, 1997, the Pichts wrote four checks, totaling $50.25, from their account. However, the couple later learned that Picht's paycheck was dishonored, and as a result, Pichts' bank dishonored those four checks. The businesses receiving the checks sent them to a collection agency, which, in turn, engaged the law firm of Jon R. Hawks as counsel to pursue collection of the debt.

In January of 1998, Hawks served a summons and complaint on the Pichts regarding

a collection action brought in Minnesota state court. The complaint claimed that the Pichts owed over $900, including $400 for the four dishonored checks. Prior to the entry of judgment in that suit, Hawks sent the Pichts a notice of intent to garnish. In July 1998, the Pichts filed suit in federal district court alleging violations of the FDCPA based. The Pichts claimed that the attorney's use of the garnishment procedure prior to entry of judgment violated Minnesota law on collection practices, and thus the FDCPA (the FDCPA prohibits the use of debt collection practices that violate state law).

The case was eventually appealed to the United States Court of Appeals for the Eighth Circuit. In Picht v. Jon R. Hawks, Ltd., 236 F.3d 446 (8th Cir. 2001), the appeals court held that the decision on whether a creditor may commence a garnishment action prior to a judgment against the debtor in a lawsuit depends on whether the creditor would be entitled to receive a default judgment. Under Minnesota law, a default judgment is only allowed when the creditor's claim against the debtor is "upon a contract for the payment of money only." Thus, a creditor may only use garnishment proceedings when the creditor's claim is only for the payment of a *specified* amount of money. The court held that a default judgment could not be entered in this case. While checks certainly create contractual obligations, the court interpreted the meaning of "contracts for the payment of money" to mean contracts where a definite contractual sum is involved, and where there is no discretion on the part of the court as to the total amount the debtor would owe. Under Minnesota's bad check law, the court has discretion over how much of a penalty to award against the debtor (i.e., "up to" $100 per bad check). Moreover, because the amount at issue in Hawks' lawsuit against the Pichts included a request for costs and attorney's fees associated with the dishonored checks, the amount was not definite. Therefore, Hawks' attempt to use the garnishment procedure before the entry of judgment in his case against the Pichts violated Minnesota's bad check law because a default judgment could not be obtained under that law. Hawk's actions in violation of Minnesota law violated the FDCPA's prohibition against threatening "to take any action that cannot legally be taken." Thus, in this case the court applied the FDCPA to a debt that involved the tender of personal checks, something about which the courts are not in agreement, as the next excerpt reveals.

SETBACK: CHECKS ARE NOT DEBTS UNDER THE FDCPA

Sanford Krevsky purchased consumer goods with a check. His bank dishonored the check and the store turned the check over to Equifax Check Services for collection. Equifax sent Krevsky several letters demanding payment, as well as a $20.00 dishonored check fee. Krevsky filed suit in Pennsylvania, alleging that the letters sent from Equifax violated the FDCPA.

The United States District Court for the Middle District of Pennsylvania held in Krevsky v. Equifax Check Services Inc., 85 F.Supp.2d 479 (M.D. PA. 2000), that a check is not considered a debt under the FDCPA. According to the court, the FDCPA covers consumer debts involving the extension of credit to the consumer. Because payment by check is equivalent to payment in cash, no extension of credit is required and thus the FDCPA does not apply to a debt collector's attempts to collect a dishonored check. The court then dismissed the complaint based on the fact that Krevsky no longer had a claim under the FDCPA.

When is a payment by check an "extension of credit?"

Courts from other jurisdictions have ruled otherwise. The Seventh Circuit Court of Appeals held in Bass v. Stolper, Koritizinsky, Brewster & Neider, 111 F.3d 1322 (7th Cir. 1997), that there is no requirement of "extension of credit" in the FDCPA's definition of a debt. The Seventh Circuit reasoned that a debt arises when a consumer creates an obligation to pay, regardless of the nature of the underlying transaction. A check, like a credit card, creates an obligation to pay. Since the courts are divided on this important issue, it is likely that the United States Supreme Court will resolve the dispute at some point in the future.

ADVANCE: PURCHASE OF BACKHOE FOR PERSONAL USE WAS CONSUMER DEBT

The FDCPA applies only to those debts that are considered "consumer" in nature. Thus, debts that are incurred as a result of a business transaction are not within the purview of the Act. In the case of Slenk v. Transworld Systems, Inc., 236 F.3d 1072 (9thCir. 2001), Robert Slenk defaulted on a loan to finance a backhoe that he purchased for personal use. Slenk claimed that the backhoe was a "consumer debt" because it was for personal use. He purchased the backhoe in 1993 to assist in the construction of his house and driveway. While Slenk owns and operates his own carpentry business, Slenk Builders, he claims the backhoe was never used for any job in connection with his business. Evidence at the trial court indicated that Slenk held a contractors license only for carpentry, and his business was not licensed to use a backhoe. In addition, Slenk sold the backhoe immediately after completing his home. On the other hand, there was evidence that Slenk purchased the backhoe for business purposes: the invoice for the sale lists "Slenk Builders" as the purchaser and indicates a reduced tax rate given for business purchases. Further, Slenk listed the backhoe as the property of Slenk Builders on his tax returns, thereby authorizing a deduction on his personal income tax.

In 1994, Slenk obtained a loan from a credit union to finance the payment of the backhoe. The loan was issued to Slenk, rather than his company. Slenk defaulted on the loan and it was turned over to Transworld Systems, a collection agency. Transworld attempted to collect the debt through both written and oral communication with Slenk and his wife. Slenk filed suit in federal district court, alleging assorted violations of the FDCPA. Transworld asserted that the debt was not a "consumer" debt and, therefore, the FDCPA did not apply to its collection efforts. The district court ruled in Transworld's favor, dismissing the case. It decided that Slenk's loan was for business, not consumer, purposes.

Slenk appealed the decision to the Ninth Circuit Court of Appeals. The appeals court held that there was an undecided issue of fact as to whether the backhoe was purchased for personal or business use. Under the FDCPA, a consumer debt relates to a transaction involving a debt for personal or household purposes. In determining whether a loan is for personal or business use, the court noted that it must view the transaction as a whole and elevate substance over form: "neither the lender's motives nor the fashion in which the loan is memorialized are dispositive of this inquiry." In order to decide what type of debt Slenk incurred in this case, the trial court should have examined the substance of the transaction, as well as Slenk's purpose in borrowing the money. The appeals court decided that is was not absolutely clear that the loan was for a business purpose, so the case should not have been dismissed. As a result, the decision of the lower court was reversed and the case sent back for trial on the issue of whether the debt could be classified as "consumer" or "business" for the purposes of the FDCPA. However, the court noted that a debt does not becomes a consumer debt merely because a debt collector contacts a consumer at home with respect to the debt. On the contrary, it is the initial transaction that will determine the nature of the debt for purposes of the FDCPA.

SETBACK: HOMEOWNERS ASSOCIATION IS NOT A DEBT COLLECTOR UNDER THE FDCPA

William and Audrey Feldmann are homeowners in a planned development community maintained by the Davis Lake Community Association. Under a number of restrictive covenants that govern the community, the Community Association has the authority to collect assessments and other maintenance charges from those living in the development. The assessments are collected on a quarterly basis. The Feldmanns failed to pay the assessments for four consecutive quarters in 1996 and 1997. The past due assessments totaled $200.95. The Community Association sent the Feldmanns several letters demanding payment, eventually retained counsel, and

filed a collection lawsuit against the Feldmanns. In response to the letters and the lawsuit, the Feldmanns tendered a check for the outstanding balance, which the Community Association returned to them because it did not include payment for attorney's fees. Counsel for the Community Association filed an affidavit claiming attorney fee's in the amount of $2378.90, ten times the amount of the outstanding balance.

The Feldmanns filed a counterclaim, alleging violations of the FDCPA. The trial court dismissed their counterclaim and ordered them to pay the outstanding balance, in addition to the attorney's fees. In Davis Lake Community Association v. Feldmann, 138 N.C.App. 292 (N.C.App. 2000), the Court of Appeals for North Carolina held that the trial court properly dismissed the Feldmann's case because a homeowner's association is not considered a debt collector under the FDCPA. According to the FDCPA, 15 U.S.C. § 1692(a) (1998), a debt collector is any person who regularly collects on behalf of others. The FDCPA does not apply to creditors trying to collect their own debts, and because the Community Association was collecting a debt owed to itself, the FDCPA does not apply to their collection practices. Thus, while a homeowner is considered a "consumer" for the purposes of the FDCPA, a homeowner's association is not considered a "debt collector."

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ACCI

Established in 1953, ACCI is a non-partisan, non-profit, professional organization governed by elected officers and directors.

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The Mission of ACCI is to provide a forum for the exchange of ideas and presentation of information among individuals and organizations that are committed to improving the well–being of individuals and families as consumers. This mission includes the production, synthesis, and dissemination of information in the consumer interest.

• Goals of the Organization

To promote the well-being of individuals and families as consumers, nationally and internationally, by identifying issues, stimulating research, promoting education, and informing policy.

To provide for the professional development of the membership by creating, maintaining, and stimulating interactive communication among advocates, business representatives, educators, policy makers, and researchers through publications, educational programs, and networking opportunities.

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