UNIT 4

Your Money and the Law

In This Unit You Will Find:

Chapter 10
Banking and Negotiable Instruments

Chapter 11
Credit and Debt

Chapter 12
Credit Protection and Bankruptcy

Methods of Payment
In the age of e-commerce virtually all purchase and credit transactions can now be done electronically. *What are some types of cards you can use to make a purchase?*

Thematic Project Preview

Correcting a Credit Report Error

As you read this unit, use this checklist to prepare for the unit project:

- ✓ List the three major credit reporting bureaus.
- ✓ Define the five main components used to calculate credit rating.
- ✓ Explain ways of repairing a low credit rating.
- ✓ Explain what information is needed to resolve a credit dispute.
- ✓ Determine the appropriate tone and style for a credit report dispute letter.

Legal Portfolio When you complete the Unit Thematic project, you will have a sample letter for reporting a credit dispute to add to your portfolio.

Find Unit 4 study tools such as Graphic Organizers, Academic Skills Review, and Practice Tests at glencoe.com.

WebQuest

Credit Rating
A good credit rating is crucial to your financial health and purchasing power. Log on to **glencoe.com** to find out how to establish, maintain, and protect a good credit rating. List your findings in your WebQuest folder to share with your class.

Ask STANDARD & POOR'S: Paying for a College Education

Q: I cannot pay for college on my own and will need to apply for financial aid. What is the best way to go about this?

A: To apply for financial aid from almost every public and private college and university in the U.S., you need to fill out the Free Application for Federal Student Aid (FAFSA). You can get the application from your guidance counselor at school or online. At many colleges and universities, the FAFSA is the only form you need to fill out. After you submit the form, the Department of Education determines your expected family contribution (EFC), which is based on your family's income and assets. Once you have been accepted to a school, you might be offered a financial aid package. This often includes a combination of loans and scholarships and possibly work-study arrangements.

Language Arts/Reading Standard & Poor's is one of the world's main providers of credit ratings and financial-market indices. Go to **glencoe.com** and read more about paying and saving for college.

Chapter 10

Banking and Negotiable Instruments

BusinessWeek News

The Great Bank Overhaul

By Brian Bremner

When Frank Newman paid a visit to Shenzhen Mayor Xu Zongheng in early June, it wasn't just to exchange pleasantries. Newman will soon be chairman of Shenzhen Development Bank (SDB), the first foreigner ever to hold such a post, and he needed Mayor Xu's help. The private bank, which is 18 percent owned by Newman's other employer, Fort Worth-based private-equity firm Newbridge Capital Group, is loaded with bad debt. Newman was there to explain his restructuring plan to the mayor and seek his help in collecting from some local deadbeats. Having seen an ornamental sword in the office of Shenzhen Vice-Mayor Chen Yingchun a week earlier, Newman said to Xu only half-jokingly, "Maybe you can use that sword on these guys." Xu smiled and assured Newman that "we will use the sword of the law."

Flex Your Reading

Efficient critical reading involves being flexible with speed and comprehension. There are several ways of reading critically, and you need to fit a reading style to your needs and to the material.

Go to **glencoe.com** for Flex Your Reading activities, more information on reading strategies for this chapter, and guided practice in reading about negotiable instruments.

For Deposit Only If your check is lost or stolen, it could be cashed by someone else. *What can you do to make sure your check can only be used to deposit in your bank account?*

SECTION 10.1

Using Negotiable Instruments

What You'll Learn

- Describe the function of negotiable instruments.
- Identify the different types of negotiable instruments.
- List the essential elements of negotiable instruments.
- Differentiate between a draft, a note, and a certificate of deposit.

Why It's Important

If you ever get a certificate of deposit or borrow money to buy a car, you need to know about the law of negotiable instruments.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Social Studies (NCSS 1) **Study culture and cultural diversity.**

English Language Arts (NCTE 4) **Adjust the use of spoken, written, and visual language to communicate effectively with a variety of audiences and for different purposes.**

Reading Guide

Before You Read

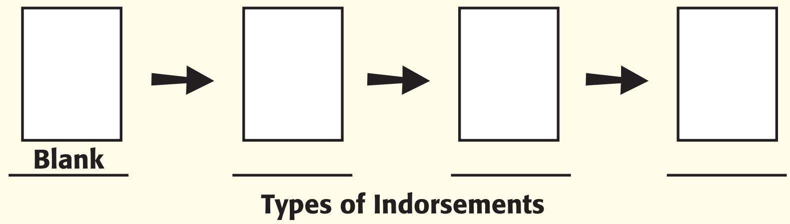
Connect Have you ever received a paper that could be exchanged for cash? If so, you have some idea of what a negotiable instrument is.

Focus on Ideas

A negotiable instrument is a written promise or order by one person to pay another.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.



Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- negotiable instrument
- note
- maker
- payee
- draft
- drawer
- drawee
- negotiation
- holder
- assignment
- indorsement
- holder in due course

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- advantage
- signature
- unconditional

Types of Negotiable Instruments

How can you guarantee payment when you have no cash or credit card?

People often need to conduct business without carrying around large sums of money or to buy items they can pay for later. Negotiable instruments were created to meet these needs.

A negotiable instrument, also known as commercial paper, is a written document giving legal rights that may be passed to others by indorsement or delivery. A negotiable instrument is a type of contract. However, the laws of negotiable instruments are governed by the Uniform Commercial Code (see Chapter 7) rather than general contract law. There are two basic kinds of negotiable instruments: notes (including certificates of deposit, stocks, and bonds) and drafts (including checks and bills of sale). Negotiable instruments can be obtained from places such as banks, credit unions, and other types of financial institutions.

As You Read

Predict How many types of negotiable instruments can you list?

Notes

A note (often called a promissory note) is a written promise to pay money. A maker is a person who promises to pay money in a note. A payee is a person in a note to whom the promise to pay is made. Two or more persons who sign a note are known as comakers. An **advantage** of using a note is that it can be negotiated (transferred) to other people easily.

Vocabulary You can find vocabulary definitions in the **Key Terms** glossary and the **Academic Vocabulary** glossary in the back of this book.

A demand note is a note that is payable at the time the payee demands payment. In contrast, a time note is a note that is payable at a future date. An installment note is a note that is paid in a series of payments. People often sign this type of note when they borrow money to buy a car or a house.

A certificate of deposit (CD) is a note issued by a bank that earns interest over time. CDs are written for specific time periods, such as six months, one year, two years, and five years. The interest on a CD is higher than the interest on a savings account because the depositor cannot withdraw the money before the due date. Banks pay higher interest for longer-term CDs.

Drafts

A note is a promise to pay money. **A draft is an order to a third party to pay money. A drawer is a person who orders money to be paid in a draft. A drawee is the person to whom an order is given to pay money in a draft.**

Although ordered to pay money, drawees are not required to do so unless they agree. Drawees agree to pay a draft by writing the word *accepted* on the document and signing their name. A drawee that has done this is called an acceptor and must pay the draft. The person to whom the draft is paid is called the payee.

A sight draft is a draft that is payable when it is given to the drawee for payment. A time draft is a draft that is not payable until a particular period of time has passed.

Letters of credit are a special type of draft used in international business. Banks issue letters of credit on behalf of buyers, agreeing to pay sellers money when specific conditions are met. The bank accepts liability for the payment of the money involved in the transaction. The seller is guaranteed payment even if the buyer changes his or her mind. However, if the bank pays, the buyer is still liable for payments to the bank.

Drafting Instruments

What makes an instrument negotiable?

To be negotiable, negotiable instruments must have several elements.

Written Instrument

The promise, or order, to pay must be in writing. It can be printed, typed, or handwritten in pen or pencil. A negotiable instrument written in pencil is, however, an invitation for forgery or alteration.

Case Study – National Credit Union v. First National Bank

Critical Thinking ***Can the federal government restrict credit union membership qualifications?***

Flex Your Reading **Note key facts in the text below and look up words you do not understand. Restate difficult ideas in your own words. Go back and reread the text quickly to make sure you did not miss any important detail. Now, you are ready to formulate an opinion.**

Open Membership? Congress passed the Federal Credit Union Act (FCUA) in 1934 during the Great Depression. The Act provided for the creation of certain federal credit unions. The credit unions were allowed to provide banking services to a select group of members as determined by the credit union's individual charter. Section 109 of the Act specifically stated:

Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district.

In 1982, the National Credit Union Administration (NCUA) allowed for multiple unrelated employer groups to become members of credit unions. As a result of the change, AT&T Family Federal Credit Union (AT&T FFCU) opened its membership to local persons unrelated to AT&T. Ultimately, only 35 percent of its members were actual AT&T employees. First National Bank & Trust Company then sued the NCUA, arguing that the FCUA did not provide for open membership to credit unions and that AT&T FFCU cannot open its membership to unrelated persons.

Nat'l Credit Union Admin. v. First Nat'l Bank & Trust Co., 522 U.S. 479 (1998)

Go to **glencoe.com** for more case study practice.

Signature of Maker or Drawer Banks keep signature cards on file to verify the signature on a check. ***What are other ways a signature can be verified?***

Signature of Maker or Drawer

A negotiable instrument must be signed. The maker must sign a note, and the drawer must sign a draft. A **signature** may be any mark placed on the instrument with the intent to be a signature. The signature on a check, however, should match the signature card on file with the bank. The signature card is a record of an account holder's signature that the bank uses to verify it.

Unconditional Promise or Order

The promise in a note, or the order in a draft, must be **unconditional**. If either is qualified in any way, the instrument is not negotiable.

Fixed Sum of Money

A negotiable instrument must be payable in a fixed sum of money. This can be in U.S. dollars or the currency of a foreign country.

Payable on Demand or at a Definite Time

Negotiable instruments must be payable on demand. Instruments that state they are payable "on demand" or "on sight" are called demand paper. Instruments must also be payable at a definite time. For instance, a check payable when a person marries or reaches a certain age is not negotiable because the time of payment is not definite.

Payable to Order or Bearer

Except for checks, negotiable instruments must be payable to order or to bearer. The words *to the order of* and *to bearer* are called the words of negotiability. The maker or drawer may write "Pay to the order of Jane Doe," "Pay to Jane Doe or order," or "Pay to Jane Doe or her assigns."

Dates and Controlling Words

When the date is omitted, the date on which the instrument is received is considered the date of issue. A check can also be post-dated, or written with a later date on it than the date it is signed.

Sometimes, due to an error or alteration, the words or figures on a negotiable instrument do not match each other. In that case, words control, or win out, over figures. Terms that are typed control terms that are printed, and terms that are handwritten control typed and printed terms.

Reading Check

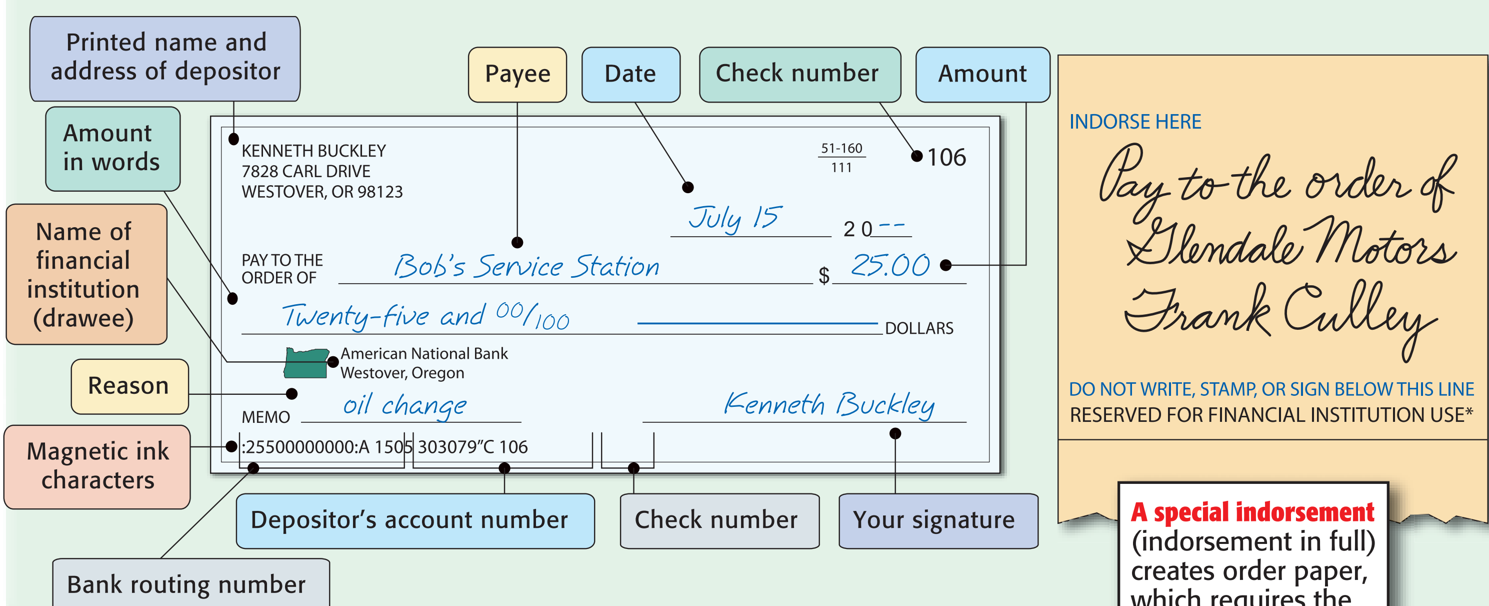
Enumerate *What are the main characteristics of negotiable instruments?*

Transferring Negotiable Instruments

What is the right way to sign a negotiable instrument?

When an instrument is signed by the maker or drawer and given to another person, the instrument is issued. When that person gives it to a third party, the instrument is transferred. The transfer can be done by assignment or by negotiation. **Negotiation is the transfer of an agreement in such a way that the transferee becomes a holder. A holder is a person who possesses a negotiable instrument payable to "the order of" the person holding it or to "bearer."** You are a holder when you receive a check made out in your name. Negotiability is the ability of an instrument to be transferred in a way that the transferee becomes a holder.

Figure 10.1 Types of Indorsements



A special indorsement (indorsement in full) creates order paper, which requires the signature of the indorsee.

An instrument is indorsed when you write your name on it, intending to transfer ownership to another. The type of indorsement depends on how much information you include. ***Why should you avoid using a blank indorsement?***

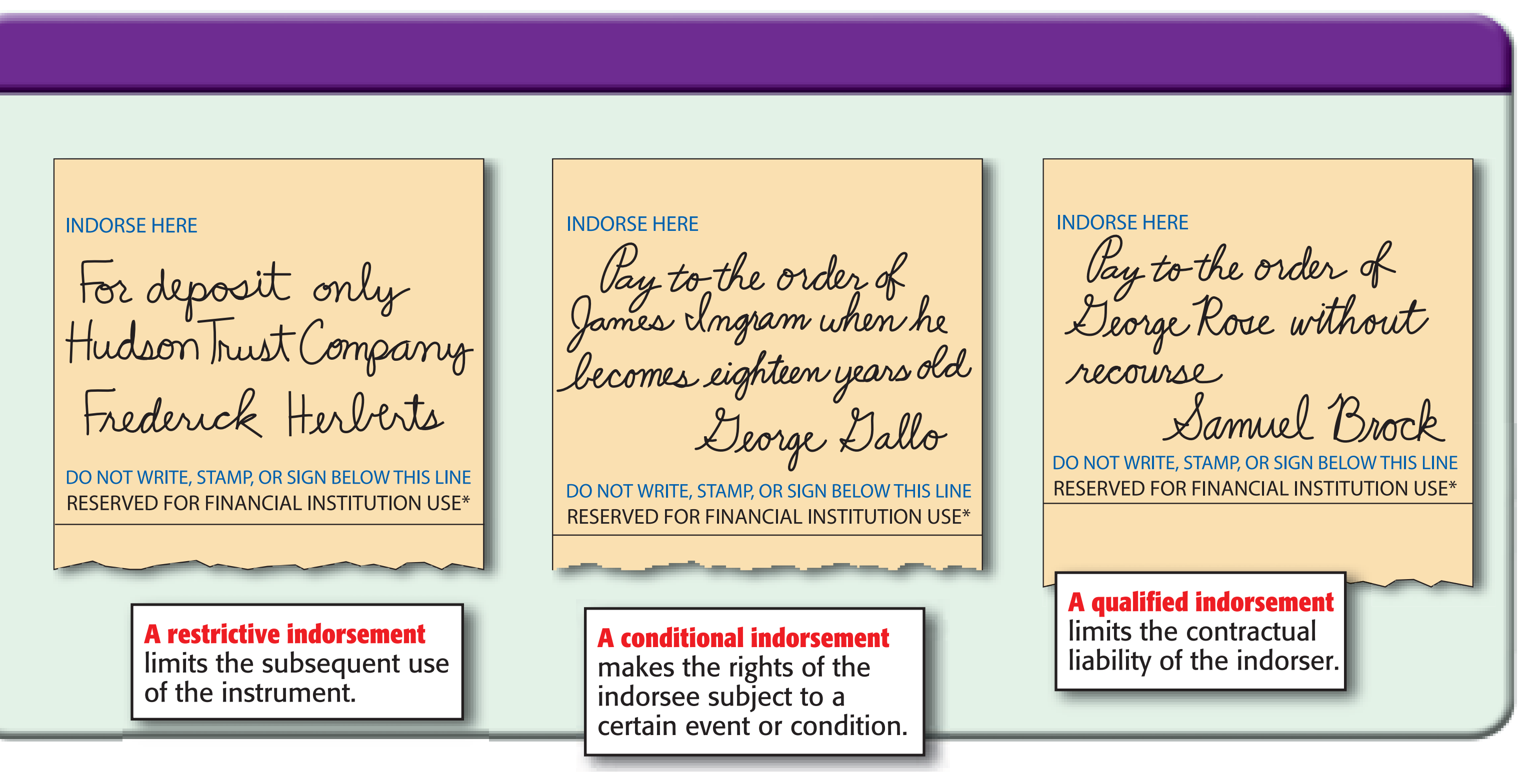
Instruments that do not meet the requirements of negotiability cannot be negotiated, but they can be assigned. **An assignment is the transfer of your rights under a contract to someone else.** Assignability is the ability of an instrument to be transferred to someone else without the transferee becoming a holder.

The person who assigns an instrument is the assignor. The person who receives the assignment is the assignee. Instruments are assigned when a person whose indorsement is required transfers the instrument without indorsing it.

Indorsements

An indorsement is the act of placing one's signature on an instrument, usually on the back, to transfer it to another. The person who writes the indorsement is called the indorser, and the person to whom the instrument is transferred is the indorsee. Indorsements may be written in ink, typed, or stamped with a rubber stamp. They are usually placed on the back of the instrument. There are four types of indorsements (see **Figure 10.1**).

Blank Indorsement A blank indorsement consists of a signature alone on the instrument. By signing an instrument in this way, you are saying in effect, "This instrument may be paid to anyone." An instrument indorsed in blank becomes bearer paper and may be transferred by delivery alone. If it is lost or stolen, someone else can cash it.



Special Indorsement A special indorsement is an indorsement with the words *pay to* or *pay to the order of*. This is followed by the name of the transferee and signed by the indorser. It is also called an indorsement in full. When indorsed this way, the instrument remains an order instrument and must be indorsed by the indorsee before negotiating it further.

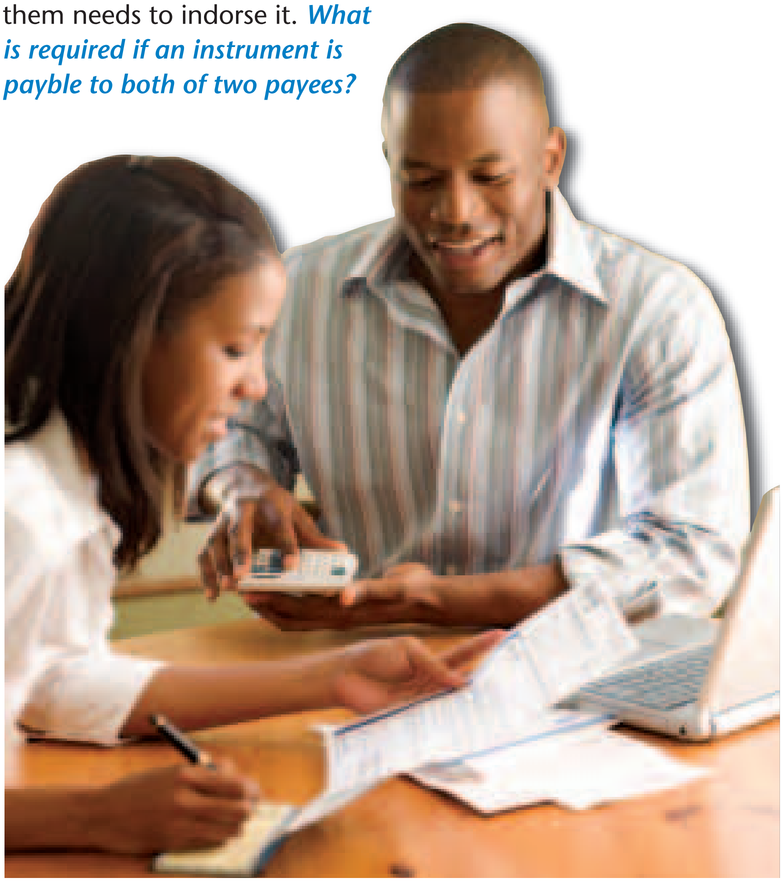
Restrictive Indorsement A restrictive indorsement is an indorsement in which words have been added that limit the use of an instrument. Before it can be further transferred, an instrument must be used as stated in the indorsement. For example, when a check is indorsed "for deposit only," that amount of money must be added to the indorser's bank account before it can be negotiated further. Retail stores often stamp checks "for deposit only" when they are received. This provides protection in the event the checks are stolen.

Qualified Indorsement A qualified indorsement is an indorsement that limits the liability of the indorser. The words *without recourse,* for example, mean the indorser is not liable if the maker or drawer does not pay.

Holder in Due Course

A holder in due course is a holder who takes an instrument for value, in good faith, and without notice that the instrument is defective. To be a holder in due course, you must first be a holder. You must also give value for an instrument, which means you give the consideration that was agreed upon, such as payment of a debt. You must take the instrument in good faith, which means to do it fairly and honestly. You must also be unaware of anything wrong with the instrument, such as a claim to the instrument by someone else, evidence of alteration or forgery, or the instrument being overdue.

Multiple Payees If an instrument is payable to either of two payees, only one of them needs to indorse it. ***What is required if an instrument is payble to both of two payees?***



Defenses to Negotiable Instruments Holders in due course take instruments free from all claims to them by anyone. They also take instruments free from all personal defenses of anyone with whom they have not dealt. They are only subject to real defenses.

Personal, or limited, defenses are defenses that can be used against a holder, but not a holder in due course. The most common personal defenses are breach of contract, lack of consideration, fraud in the inducement, lack of delivery, and payment.

Real, or universal, defenses are defenses that can be used against everyone, even holders in due course. No one is required to pay an instrument when there is a real defense. Real defenses include mental incompetence, illegality, duress, bankruptcy, unauthorized signature, and alteration.

Liability

No person is liable on an instrument unless that person's signature appears on it. A signature can be written by an authorized agent. Parties to negotiable instruments have different liability.

The following (formerly known as primary parties) are absolutely liable to pay:

- the maker of a note
- the issuer of a cashier's check or other draft in which the drawer and drawee are the same person
- the acceptor of a draft

When there are two or more makers on a note, all have absolute liability. Very often, one of the comakers is the person who borrowed the money. The other serves as a surety—a person who promises to pay another's debt whether or not the other defaults.

Discharge of Negotiable Instruments

Obligations of parties to pay negotiable instruments are discharged by payment, by agreement, by the debtor becoming the holder after maturity, and by the intentional cancellation of the instrument by the holder. Indorsers are discharged when anyone entitled to enforcement extends the due date, or agrees to modify the instrument.

After You Read

Summarize How can you transfer negotiable instruments?

Section 10.1 Assessment

Self Check

1. What is the difference between a note and a draft?
2. What qualifies as a signature on a note or draft?
3. What is an indorsement?

Academic Connection

Social Studies The use of metal for money can be traced back over 4,000 years. The first coins were made of electrum, a natural mixture of silver and gold. They were crude lumps of metal bearing a primitive mark that certified its weight or fineness. Beads, shells, and even leather were also used to create money. Go on the Internet or to the library to look up what other cultures have used as a form of money or currency and make a short list of them.

English Language Arts Get together in teams with other students in your class. Using props, drawings, or other visual means of communication, describe what each of the key terms in this section refer to and how they relate to each other.

Critical Thinking

Negotiable Instruments Why do you think a person who writes a negotiable instrument in pencil would be responsible for any loss due to negligence?

Go to **glencoe.com** to check your answers.

SECTION 10.2 Banking Basics

What You'll Learn

- Explain the contractual relationship between a bank and its customers.
- Distinguish stop-payment orders, forgeries, and material alterations.
- Differentiate between types of checks.
- Define electronic fund transfer.

Why It's Important

You need to know what your legal rights and duties are when you open a checking account.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Math (NCTM NOS 2)
Understand meanings of operations and how they relate to one another.

Social Studies (NCSS 5)
Study interactions among individuals, groups, and institutions.

Reading Guide

Before You Read

Connect Take a note card or cut out a piece of paper and sign your name on it. Now give it to the teacher. You have just created a signature card.

Focus on Ideas

Checks are the most common type of negotiable instrument.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.

Other Types of Checks
- **Certified—guaranteed by bank**
-
-
-
-

Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- forgery
- electronic fund transfer (EFT)

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- schedule
- reconcile
- substitute

Checking Accounts

How does a checking account work?

The check is the most common type of negotiable instrument. The parties to a check are the same as the parties to a draft. The person who writes the check is the drawer. The bank that is ordered to pay the money is the drawee. The one to whom the check is payable is the payee.

To open a checking account, you deposit money in a bank and sign a signature card. A signature card is a record of your signature the banks uses to verify your identity.

A checking account creates a contractual relationship between a bank and a customer. When you write a check, you order your bank to pay someone money from your checking account. The bank agrees to pay money out, up to the amount you have deposited when you write a check. People to whom you write checks can cash them or deposit them in their own bank. Their bank then collects the money from your bank, which takes it out of your account. If your bank refuses to cash your check when sufficient funds are on deposit, it would be a breach of the bank's contract.

A bank may refuse to pay a stale check, which is a check that is more than six months old. A bank may also refuse to pay a check if it is submitted ten days after the death of the drawer.

As You Read

Predict Is it a crime if you write a check and do not have enough money in your checking account to cover it?

CYBERLAW

Hospicomm, Inc. v. Fleet Bank, N.A.

338 F.Supp.2d 578 (E.D. Penn. 2004)

Hospicomm, Inc. provides data processing and other management services to health care providers. In 2002, Hospicomm began to provide services to Hamilton Continuing Care Center. On Hamilton's behalf, Hospicomm opened several bank accounts with Fleet Bank. Access to those bank accounts was limited to those persons who were authorized signatories on the account. In 2003, Hospicomm ended the employment of Guillermo Martinez. It was discovered that Mr. Martinez, without authorization, had obtained an ATM card for the Fleet Bank accounts over the Internet and had withdrawn $148,000 from the accounts. Hospicomm sued Fleet Bank for negligence in giving Mr. Martinez an unauthorized ATM card and allowing the unauthorized ATM withdrawals.

Ruling and Resolution

The Federal District Court held that Hospicomm could not sue Fleet for negligence since the relationship between Hospicomm and Fleet was based in contract. Further, the Court held that the UCC does not apply because ATM transactions are not considered banking deposits or collections.

Critical Thinking Should the UCC be updated to cover electronic transactions such as ATM usage?

Legal Talk

Forge: *v* To imitate falsely with intent to defraud. From Latin *fabrica* = workshop.

Certified: *adj* Officially endorsed or attested to. From Latin *certus* = certain + *facere* = to do: to make certain.

Vocabulary Builder The Latin root *facere* means to do, to make, or to form. List and define three words that have *facere* as a root.

Look it up! Check definitions in *Black's Law Dictionary* or an online glossary. For direct links, go to **glencoe.com** to find more vocabulary resources.

Availability of Funds

Under federal law, banks must make funds available to you according to a set **schedule**. Exceptions are made for new accounts, accounts that are often overdrawn, and suspicious deposits. Some state laws require even shorter time periods for banks to make funds available.

Balancing Your Checkbook

Whenever you write a check, you should record it in your check register, a checkbook log of all your checking transactions. Every month you should receive a statement of the bank's record of all your transactions, called a bank statement. You should balance—or **reconcile**—your bank statement soon after receiving it. Carefully compare the check register balance with the bank statement balance to be sure they agree. Do not forget to account for outstanding checks. Outstanding checks are checks you have written that have not yet been returned to the bank for payment.

The Check 21 Act

Physically moving paper checks throughout the country can take time and increase the possibility of checks getting lost or mishandled. Congress enacted the Check 21 Act (named after the 21st Century) which allows electronic processing to clear checks quickly and safely. An instrument called a **substitute** check is used. A substitute check is a paper copy of both sides of an original check. Check 21 also allows for an electronic signature to replace an original signature on the substitute check. It is processed just like the original check. Bank customers no longer have the right to have their original canceled checks returned to them.

Vocabulary You can find vocabulary definitions in the **Key Terms** glossary and the **Academic Vocabulary** glossary in the back of this book.

Writing Checks

You should take care to write checks so they cannot be changed easily. You are responsible for altered checks only if your negligence contributed to the alteration. Sign your name in ink. Sign it the same way it appears on the bank signature card, such as with a middle initial. Never sign a blank check. Never cross out or change a check once it has been written. If you make a mistake when writing a check, shred it and write a new one.

Stopping Payment of a Check

Sometimes you want to cancel a check you have already written but has not yet been paid. You can put a stop on the check by requesting a stop-payment order from your bank. An oral stop-payment order is binding on the bank for 14 calendar days, unless the order is confirmed in writing within that period. A written stop-payment order is effective for six months, unless it is renewed in writing. If the bank pays the check anyway, it is liable for any loss you suffer as a result. If you stop payment on a check given in payment of an amount actually owed, you still owe the amount of the debt.

Reading Check

Interpret *Why do you think a bad check is also called a bounced or rubber check?*

Bad Checks

A bad check, also called a bounced check or rubber check, is a check you draw on an account in which you do not have enough funds. Unless it is accidental, writing a check on an account with insufficient funds is a crime.

Forgeries and Material Alterations

Suppose a large amount of money disappears from your checking account. You discover someone has stolen one of your checks and faked your signature on it or changed the amount on a check you wrote to a much larger amount. This is called forgery. **Forgery is the fraudulent making or material alteration of a writing.** A forged check is one that is signed by someone other than the drawer without authority. A material alteration occurs when someone changes a check you wrote, such as adding an extra "0" to the amount. Forgery is a crime subject to a fine and imprisonment. It is the bank's duty to know the signatures of its depositors.

Global Law

Banking in Switzerland

Since 1685, Swiss banks have provided services to their clients that range from ordinary checking accounts to large numbered accounts. Swiss banks also provide services such as offering stocks and bonds for sale.

Secrecy

One of the most famous aspects of Swiss banks is their attention to secrecy.

As in most countries around the world, banks are prohibited from giving out any information about their clients. Swiss banking law was amended in 1934, one year after Adolph Hitler became Chancellor of Germany, to create criminal penalties for any bank employee who divulges information about a client's account.

The penalties include six months in jail and/or a fine of 50,000 Swiss Francs (approximately $39,000). There are only four reasons why a bank may give secret information about a client to another party:

1. a criminal investigation (national or international)
2. an investigation by financial market authorities
3. bankruptcy proceedings
4. some civil proceedings (such as inheritance and divorce cases)

Secret numbered accounts enjoy the same protections as named accounts. The main distinction is that only a few select people in the bank know the names associated with the accounts. In other words, there are really no anonymous bank accounts in Switzerland. Someone always knows who owns the money.

Across Cultures: Lingua Franca

Switzerland has four official languages: French, German, Italian, and the native language of Romansh. However, the language used to conduct business internationally, or the lingua franca, is English.

Critical Thinking *Why do you think Switzerland passed such strict banking laws when it did?*

Electronic Banking With electronic banking, you can withdraw or deposit money, or check your account balance 24 hours a day. ***Can a debit card be used the same as a credit card?***

If a bank pays a forged check and the drawer was not negligent, the bank must bear the loss. The bank must also bear the loss if a check is changed from its original amount to a higher amount.

Knowingly giving a forged instrument to someone else is a criminal offense called uttering. You are guilty of this crime even if you did not personally commit the act of forgery. If one of your checks is forged, you must notify your bank within a reasonable time. Otherwise, the bank is relieved of liability.

Other Types of Checks

If you do not have a regular checking account or need to use a check for a special purpose, such as a gift or to write checks in a foreign country, you can purchase other types of checks from banks and other financial institutions. These other types of checks include:

- certified checks, which are checks guaranteed by a bank
- cashier's checks, which are checks drawn by a bank upon itself
- bank drafts, which are drawn by a bank against funds the bank has on deposit with another bank
- money orders, which are drafts that substitute for checks and may be purchased from places such as banks and post offices
- traveler's checks, which are like cashier's checks in that the financial institution that issues them is both the drawer and the drawee

Electronic Banking

Can you pay for things using your checking account without writing a check?

Computer technology and the Internet have greatly reduced the need to use paper and increased the speed of banking transactions. **Electronic fund transfer (EFT) is a computerized system for transferring funds electronically rather than by writing checks.** With electronic banking, or e-banking, you can access your bank account on a computer or by using a debit card. A debit card, also called an ATM card or a check card, is a bank card that takes money from your own bank account, as if writing a check.

EFT is safe, secure, and less expensive than paper check payments. When you purchase a product online using EFT, you can pay for it by having money transferred from your checking account to the checking account of the seller. You can also use EFT to pay routine bills online.

To regulate this means of banking, the federal government enacted the Electronic Fund Transfer Act (EFTA). Under the EFTA you can:

- purchase merchandise at a store with your debit card
- withdraw money from your bank at an automated teller machine (ATM) 24 hours a day
- authorize your employer to deposit your earnings directly into your bank account
- authorize direct withdrawals from your account to pay bills automatically
- make payments from your bank by telephone
- use your computer to view your account balances and pay bills electronically
- have your paper check changed to an e-check (electronic check) so that it can be processed instantly

If your debit card is lost or stolen, you must notify the bank within two business days after learning that the card is missing. You will then lose no more than $50 if someone else uses your card. If you do not notify the bank within two business days and your card is used, you can lose as much as $500, or even more if 60 days have passed.

After You Read

Summarize Who are the different parties to a check?

Section 10.2 Assessment

Self Check

1. How do you open a checking account?
2. Summarize the process of balancing your checkbook.
3. What should you take care to do when writing a check?

Academic Connection

Mathematics Aisha Brewer's checking account has a balance of $523.45. She has a check for $435.62 and a check for $65.98. She would like to receive $40 in cash and deposit the rest of the money in her checking account. What is Aisha's total deposit and what will her new checking account balance be?

CONCEPT **Number and Operations:** To calculate the amount of the deposit, first add the total amount of the items to be deposited and then subtract the amount of cash to be received. Next, to obtain the new checking account balance, take the current balance and add the amount of the net deposit.

Math For more math practice, go to the Math Appendix.

Critical Thinking

Stop-payment Order Why might you want to stop payment on a check?

Go to **glencoe.com** to check your answers.

Chapter 10 Review and Assessment

Summary

Section 10.1 Using Negotiable Instruments

- There are two basic kinds of negotiable instruments—notes and drafts. A note is a promise to pay money. A draft is an order to a third party to pay money.
- To be negotiable, an instrument must be in writing, signed by the maker or drawer, and contain an unconditional promise or order to pay.
- An instrument must be made out for a fixed amount of money, payable on demand or at a definite time.
- The four types of indorsements are blank indorsements, special indorsements, restrictive indorsements, and qualified indorsements.
- A holder in due course must take an instrument for value, in good faith, and without notice that the instrument is defective.

Section 10.2 Banking Basics

- The check is the most common type of negotiable instrument. The parties to a check are the same as the parties to a draft.
- When you write a check, you order your bank to pay someone money from your checking account. If your bank refuses to cash your check when sufficient funds are on deposit, it would be a breach of the bank's contract.
- You can put a stop on the check by requesting a stop-payment order from your bank.
- A forged check is one that is signed by someone other than the drawer without authority. A material alteration occurs when someone changes a check you wrote.
- Electronic fund transfer (EFT) is a computerized system for transferring funds electronically rather than by writing checks.

Vocabulary Builder

1 On a sheet of paper, use each of these terms in a sentence.

Key Terms

- negotiable instrument
- note
- maker
- payee
- draft
- drawer
- drawee
- negotiation
- holder
- assignment
- indorsement
- holder in due course
- forgery
- electronic fund transfer (EFT)

Academic Vocabulary

- advantage
- signature
- unconditional
- schedule
- reconcile
- substitute

Go to **glencoe.com** to play a game and improve your legal vocabulary.

Chapter 10 Review and Assessment

Key Points Review

Answer the following questions. Refer to the chapter for additional reinforcement.

2. What are the different types of negotiable instruments?
3. Who are the parties to each kind of negotiable instrument?
4. What are the elements of negotiable instruments?
5. What are the different types of indorsements?
6. What are the requirements to be a holder in due course?
7. What is a stop-payment order, and what are the different types?
8. What are the legal responsibilities for forgeries and material alterations?
9. What are electronic fund transfers?

Standardized Test Practice

10. **Read the following excerpt from the Uniform Commercial Code (UCC) and complete problems 1 and 2.**

§ 3-104. NEGOTIABLE INSTRUMENT.

(e) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument could be a note or a draft, a person may treat it as either.

(f) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank or (ii) a cashier's check or teller's check.

(g) "Cashier's check" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) "Teller's check" means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "Traveler's check" means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

1. If an instrument could be a note or a draft

A. it must be treated as a note
B. it must be treated as a draft
C. it may be treated as either
D. it must be treated as neither

2. Which of the following is *not* true about a traveler's check?

A. It is payable on demand.
B. It is drawn on or payable at or through a bank.
C. It is a type of draft.
D. It is a type of note.

Test-Taking Strategies Before a test or exam, break study sessions into manageable time segments and meaningful units.

Apply and Debate

Read the following scenarios. Get together with other students in pairs or groups of three and take a position on each scenario. Debate your position in class with students taking the opposite position or prepare a written argument justifying your position.

11 Checks

Alan filled out a check in red ink to pay for a new suit. The cashier said the bank would not cash the check and refused to accept it. Alan disagreed.

You Debate *Who is correct, Alan or the cashier?*

12 Check Dispute

Smita paid $100 for textbooks at the college bookstore by check. She incorrectly wrote the number $1,000.00 on the check rather than $100.00. She correctly wrote the words "one hundred and no cents." When Smita received her bank statement, she saw the check had been cashed for $1,000 and not $100. She notified the bookstore of the error, but the bookstore refused to refund the $900 over-payment.

You Debate *Can Smita require the bank to credit her account for $900?*

13 Overdrawn

Harriet post-dated a check to Xander and asked him not to cash it until Friday. That same day Xander took the check to the bank, which cashed it. When Harriet looked at her account balance a couple days later, she discovered she was overdrawn.

You Debate *Is the bank responsible for not checking the date, and should it have refused the check?*

14 Negotiability

Macy took her car in for repairs. When she arrived at the garage to pick it up, she realized she did not have her checkbook. Macy drew a picture of a check made out to the mechanic with the name of her bank, account number, date, and signature for payment.

You Debate *Is Macy's drawing of a check a negotiable instrument?*

15 Forged Checks

Robin hired a cleaning company to shampoo her carpets. A couple days later, she discovered some of her checks were missing. When she notified the bank, she learned that several checks had been forged and cashed.

You Debate *Is Robin liable for the amount of the money taken from her account?*

Case Study Practice – Leavings v. Mills

⑯ **What Is a Negotiable Instrument?** In 1984, John and Evelyn Leavings contracted with Solar Marketing to have a heating system installed in their home. The Leavings signed a note with Solar Marketing to make 120 monthly payments in the amount of $146.82 each. Solar Marketing then placed a lien on the Leavings's property.

Solar Marketing assigned the note and lien to Briercroft Service Corporation (BSC). BSC, in turn, assigned the note and lien to Briercroft Savings Association (BSA). After numerous problems with the system, the Leavings stopped making payments. BSC sent a letter in 1989 advising the Leavings that their note was in default. The Leavings's attorney responded to BSC. BSC did not pursue demands for payment any further.

In 1997, after Mr. Leavings had died, Mrs. Leavings received a letter from a Mr. James Mills. The letter stated that Mrs. Leavings's installment contract had fully matured and she must pay $21,196 immediately or Mr. Mills would foreclose on her property. Mrs. Leavings argued that Mr. Mills could not foreclose on the property because the contract was not payable "to bearer" or "to order" and thus was not a negotiable instrument.

Source: Leavings v. Mills, 175 S.W.3d 301 (Tx. Ct. App. 2004)

Practice Is the retail installment contract a negotiable instrument?

⑰ Ethics Application

Who Is Responsible? Deborah goes to the bank to cash her payroll check for $160. At the bank, the teller accidentally gives Deborah $180. Deborah instantly notices the error but puts the money into her wallet and leaves the bank.

◆ Is not telling the bank teller that she gave you too much money the same as stealing?

⑱ Internet Application

Research CDs Aida's company gave her a $4,000 bonus. She wants to put the money in a safe investment. After looking at several options, she decides to invest the money in a certificate of deposit (CD).

Go to **glencoe.com** to access the Web site sponsored by the Federal Deposit and Insurance Corporation (FDIC) to learn about tips for investing in CDs. Summarize the information into a table to present to your class.

Reading Connection

Outside Reading Go to **glencoe.com** for a list of outside reading suggestions about certificates of deposit and other types of negotiable instruments.

Chapter 11

Credit and Debt

BusinessWeek News

Swiping Back at Credit-Card Fraud

By Robert Berner and Adrienne Carter

Every other week, it seems, another bank, credit-card company, or data-processing outfit announces a security breach of personal financial data. With criminals freely trading card numbers, Social Security numbers, and mothers' maiden names, you might think credit-card fraud was going through the roof.

In the past couple of years, however, bigger e-tailers such as Amazon.com Inc. and eBay Inc. have gotten more aggressive, adding staffers to combat fraud and sophisticated technology to screen for it. In addition, they have shared information on the problem and worked more closely with credit-card associations, banks, and agencies such as the FBI. That has prompted fraudsters to switch to smaller retailers, who can't afford those defenses and who don't work closely together. "So much for the Internet leveling the playing field," says Avivah Litan, an analyst at research firm Gartner Inc.

Flex Your Reading

Efficient critical reading involves being flexible with speed and comprehension. There are several ways of reading critically, and you need to fit a reading style to your needs and to the material.

Go to **glencoe.com** for Flex Your Reading activities, more information about reading strategies for this chapter, and guided practice in reading about credit.

Buying on Credit Some purchases are too expensive to pay for in cash and you need to use credit. ***What is the maximum percentage of your monthly income that should go to making credit payments, according to financial experts?***

SECTION 11.1 Understanding Credit

What You'll Learn

- Define the main types of credit.
- Explain what a secured transaction is.
- Describe how a security interest is created.
- Identify the main types of collateral.

Why It's Important

You need to know what your legal obligations are when you borrow money or obtain credit.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Social Studies (NCSS 2) **Study the ways human beings view themselves in and over time.**

English Language Arts (NCTE 6) **Apply knowledge of language structure, language conventions, media techniques, figurative language, and genre to create, critique, and discuss print and non-print texts.**

Reading Guide

Before You Read

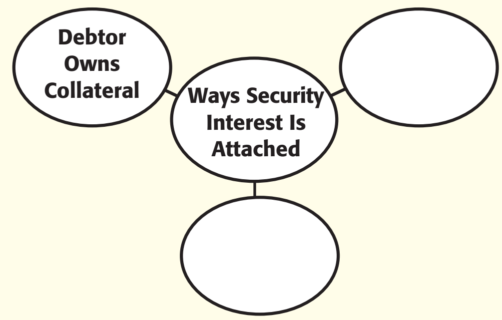
Connect Have you ever used a credit card or borrowed money to buy something you could not afford?

Focus on Ideas

To borrow money or buy on credit, you need to own something of value.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.



Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- credit
- creditor
- debtor
- interest
- secured loan
- collateral
- security interest
- default

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- assets
- acquired
- effective

Credit

What is a possible financial solution if you really need to buy something and you do not have enough money?

Credit is an arrangement in which you receive cash, goods, or services now and pay in the future. The creditor is the party who sells the goods on credit or lends the money. The debtor is the party who buys the goods on credit or borrows the money. Interest is a fee creditors charge for lending money or extending credit.

The amount of interest you pay depends on the amount of the loan or purchase, the length of time it takes to pay back the money, and the interest rate. The longer you take to pay off a loan and the larger the amount of the loan, the more you have to pay in interest.

As You Read

Predict What can happen if you are unable to repay a loan?

Open-End Credit

Open-end credit is credit that can be increased by the debtor by continuing to purchase goods or services on credit, up to a certain limit. You are given a line of credit—a maximum amount of money available to you. Credit cards issued by a bank, such as Visa and MasterCard, and charge cards for a particular store, such as Macy's and Target, are examples of open-end credit.

Closed-End Credit

Closed-end credit is credit given for a specific amount of money, which cannot be increased by making additional purchases. Buying a vehicle, a house, a refrigerator, or a couch for a fixed amount and paying for it in monthly installments is an example of closed-end credit.

Business ETHICS

Necessary Guarantors and Sureties

You are the owner of a local major appliance store that sits on the border of two states. As normal practice, you allow your customers to buy items on credit, while retaining a security interest in the appliance. However, through your personal experience, you feel that residents from your neighboring state are more likely to default on their loans than the residents in your own state. After talking to fellow business owners, you discover that one option would be to require buyers from the neighboring state to have a guarantor or a surety when they sign a credit agreement with you.

Critical Thinking: *Should you require buyers from a neighboring state to have a guarantor or surety?*

Obtaining Credit

If you borrow money, how can the creditor be sure the money is not lost?

To obtain credit or a loan, you need to fill out an application from a store, bank, or other financial institution. Lenders will usually check into your credit history, your income, and your **assets**, to determine if you are a good credit risk. Lenders also need security—a way of getting their money back in case the borrower does not pay.

Secured Transactions

A secured loan is a loan which is backed up by property that the creditor can take if the loan is not repaid. Collateral is the property that is offered as a security interest. A security interest is a creditor's right to use collateral to recover a debt. Main types of collateral are consumer goods, fixtures, equipment, inventory, and farm products.

A security can be created by the creditor possessing the collateral. It can also be created by the debtor signing a security agreement that identifies the collateral. The lender who holds the security interest is called the secured party.

If a debtor defaults, the secured party may take the collateral and sell it at a public auction or private sale. **Default is failure to make timely payments on a loan.** Different types of collateral have different laws with regard to default. There are more conditions when a debtor defaults on something as major as a home loan than when a debtor defaults on a car loan.

An unsecured loan does not require any collateral. However, because the risk is much greater to the creditor, the interest on an unsecured is usually much higher than on a secured loan. Unsecured loans are usually available only to well-established businesses or customers.

Attachment of Security Interest A security interest is said to attach when it is legally enforceable by the secured party. Attachment occurs when:

- The debtor owns the collateral.
- The secured party transfers something of value, such as money or goods, to the debtor.
- The secured party either takes possession of the collateral or signs a security agreement.

Credit Score Once you start using credit cards, paying bills, and borrowing money, credit reporting agencies collect financial information on you and assign you a credit score. *Why is your credit score important?*

Vocabulary You can find vocabulary definitions in the **Key Terms** glossary and **Academic Vocabulary** glossary in the back of this book.

Security agreements may contain provisions that include future advances of credit. Future advances of credit allow the debtor to get additional credit in the future that is secured by the same collateral, such as a house.

In a transaction for the sale of goods, the security interest attaches to the actual individual goods. In contrast, when the security interest is on inventory, which are all the things you own, the security interest attaches to the inventory as a whole, including new inventory that comes and goes from a business. The inventory is what is called after-acquired property, since the property was **acquired** after the credit agreement was entered into.

Reading Check

Interpret *What is secure about a secured loan?*

Example Good Health Grocers bought ten cases of a special health food from a wholesaler on credit. The security agreement signed by the grocer contained a clause covering all future goods the grocer bought. In this way, all replacement goods were covered by the original security agreement as the grocer's inventory was continuously sold and restocked.

Case Study – Fifth Third Bank/Visa v. Gilbert

Critical Thinking ***Can an unemancipated minor be liable for unauthorized charges she made on her father's credit card?***

Flex Your Reading **Note key facts in the text below and look up words you do not understand. Restate difficult ideas in your own words. Go back and reread the text quickly to make sure you did not miss any important detail. Now, you are ready to formulate an opinion.**

Necessary Expenses? John Gilbert was having domestic problems and no longer wanted to have a joint credit card account with other members of his family. On May 9, 1983, he canceled his Visa credit card, and on June 6, 1983 he applied for a new one from Fifth Third Bank. The credit card application included a space for additional authorized users. Mr. Gilbert left it blank.

The application was approved and fifteen days later, one credit card was issued with Mr. Gilbert's name on the front. The card was sent to Mr. Gilbert's business address. During the next month, approximately $1,300 in charges were made on the card. When Mr. Gilbert got his statement in the mail, he notified Visa that all $1,300 were unauthorized charges.

Visa then conducted an investigation and determined that the charges were made by three people. Mr. Gilbert admitted to charging $90. His married daughter, Christine, charged $85. His unemancipated daughter, Ann (who lived separately with her mother), charged the remaining $1,125. Visa then sued to recover the amount from Ann.

Fifth Third Bank v. Gilbert, 478 N.E.2d 1324 (Ohio Mun. Ct. 1984)

Go to **glencoe.com** for more case study practice.

Perfection of Security Interest When a security interest attaches, it is **effective** only between the debtor and creditor. To be effective against the claims of any other creditors, a creditor must perfect the interest. A security interest is perfected when the secured party has done everything that the law requires to give the secured party a greater claim than anyone else has.

A security interest can be perfected in three ways:

- attachment alone for consumer goods bought in a store
- filing a financial statement in a public office for most other items
- possession of the collateral (such as with a pawn shop)

Example When Jane bought a truck, the dealer took a security interest in the vehicle. To protect the dealer's rights in the vehicle, notice of the security interest would be written on the back of Jane's certificate of title to the truck.

After You Read

Summarize Who are the various parties to credit?

Guarantors and Sureties

A loan can be protected by having another party stand behind the loan to guarantee it will be repaid. There are two types of parties who can guarantee a loan: guarantors and sureties. A guarantor, sometimes referred to as a secondary party, agrees to pay off a debt only if the debtor defaults. A surety, sometimes called a primary party, agrees to pay off a debt outright, just as the debtor would have.

There are certain defenses guarantors and sureties can use when called upon to pay back a loan. These include that the debtor has already paid back or released the debt, their own minority, insanity, or bankruptcy.

Section 11.1 Assessment

Self Check

1. Give some examples of open-end credit and closed-end credit.
2. What are the main types of collateral?
3. What are future advances of credit?

Academic Connection

English Language Arts The history of credit and banking goes back at least 4,000 years to ancient Egypt. The Egyptians used a type of banking called the giro system, in which grain was deposited in state-run storehouses and could be used to pay off debts. In medieval Italy, loans and other banking transactions were conducted in large open areas where each merchant would work from a bench, or *banco*, which is where we get the word *bank* from.

Go on the Internet or to a library and look up how these first banks worked and write a brief description of them.

Critical Thinking

Credit and Debit How is a credit card different from a debit card?

Go to **glencoe.com** to check your answers.

Credit and You

SECTION 11.2

Reading Guide

Before You Read

Connect Do you have a department store charge card? If so, you are familiar with having credit.

Focus on Ideas

Credit cards, charge cards, car loans, and student loans are types of credit.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.

Advantages of Credit	Disadvantages of Credit
Finance Large Purchases	

Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- finance charge
- annual percentage rate (APR)

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- involved
- unauthorized
- subsidized

What You'll Learn

- Define finance charge and annual percentage rate.
- Describe the advantages of using a credit card.
- Determine how to obtain student loans.
- Recognize the warning signs of debt problems.

Why It's Important

There are things you need to know if you want to finance a car, get a credit card, or take out a student loan.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Social Studies (NCSS 5)
Study interactions among individuals, groups, and institutions.

Math (NCTM PSS 3)
Apply and adapt a variety of appropriate strategies to solve problems.

As You Read

Predict What is an APR?

Financing Your Future

What are some things you might need and that might cause you to borrow a large amount of money?

You will need to use credit to finance many things from short-term goals, such as buying a computer, to long-term goals, such as buying a house (see **Figure 11.1**). To build up credit for long-term goals, you need to set priorities, start with small purchases, and stay within your credit limit and income.

Buying a Vehicle

What can you do if you cannot afford to buy a car with cash?

You will probably buy many automobiles in your life. The law that applies to these purchases comes from several different sources. Because cars are considered goods, the Uniform Commercial Code (UCC) applies to their sale. If you buy a car for personal purposes, both federal and state consumer protection laws apply. In addition, if you finance the car, special laws regulate credit.

If you want to buy a car, you should first find out how much you can afford. This depends on your savings, monthly earnings, living expenses, and the amount of your debt.

Financing a Vehicle

When buying a car, you can save money by paying cash because car loans require you to pay interest. Offering to pay cash also puts you in a better position to negotiate a lower price. If you need to borrow money, you can save by shopping around. Federal law requires lenders to disclose the finance charge and annual percentage rate (APR) to borrowers. **The finance charge is the cost of the loan in dollars and cents. The annual percentage rate (APR) is the true interest rate of the loan.**

Before you sign any documents, you should know the following information:

- the exact price you are paying for the vehicle
- the amount you are financing
- the finance charge
- the APR
- the number and amount of payments
- the total sales price (the sum of the monthly payments plus the down payment)

Dealers sometimes offer very low financing rates for specific models but may not negotiate. They also may require a large down payment. As a result, it is sometimes better to pay higher financing charges on a car with a lower price or to buy a car that requires a smaller down payment.

Figure 11.1 Financing Future Goals

Your future goals might involve long-term or short-term financial commitments. ***What are some immediate financial goals you have?***

Global Law

German Lemon Law

As a member of the European Union, Germany was recently directed to change its laws on the sales of tangible property, including the sales of vehicles, to better protect the consumer. Previously, dealers of automobiles could provide little or no warranty as to the condition of used vehicles it sold. Now the consumer has the benefit of Germany's own lemon law.

1. All German dealers must warrant used cars for a minimum of one year. Unfortunately, this applies only to dealerships and does not apply to private sales of used cars.
2. The dealer is responsible for any defect determined to have been present at the time of sale. There is no protection for damage done during normal wear and tear on a vehicle. For example, worn brake pads are probably not warranted. The determination is normally done by an independent third-party appraiser.
3. The claim must be filed within one year of the purchase of the vehicle. There is no additional time period for the filing of claims. Claims can only be filed during the one-year period.
4. The European Union directive applies to all mobile property. A European Union directive that required member states to pass statutes providing for consumer protection also applies to other sales of goods. Therefore, not only is there a one-year warranty on cars, but on other items such as televisions and motor homes.

Across Cultures: European Union Protections

Although this example details the German law, the European Union directive applies to all member countries of the European Union. Those countries must also pass similar warranty laws for their citizens.

Critical Thinking: ***What are the benefits and detriments of having a mandatory one-year warranty on all goods?***

Defective Vehicles

Some cars continually have mechanical problems. The seller may be liable on any of the following grounds:

- breach of an express warranty, if a guarantee was made and not kept
- breach of warranty of merchantability, if the seller was a dealer and the car was not fit to drive
- fraud or breach of an express warranty, if the seller made any statements about the car that were not true
- breach of the state consumer protection law, if the vehicle was for non-business use

Using Credit Cards

What are some of the costs of using credit?

When you use a credit card, you are borrowing money. The interest rate and late-payment fees can be very high unless you pay your bill by the due date. You can go deeply into debt, even bankrupt, if you do not use your credit card carefully. In order to make a wise decision when purchasing on credit, you must consider all the fees and costs **involved**.

Example Tim charged many items on his credit card, up to its $2,000 limit. Each month he pays $40 on the account, the minimum required by the card issuer. The interest rate is 19 percent. If Tim maintains the same payment rate, it will take him 33 years to erase the debt. He will pay $7,000 in interest on the $2,000 that he borrowed to make his purchases. Tim could save a lot of money by doubling his monthly payments and making every effort to bring the account balance down to zero as soon as possible.

There is an advantage to using a credit card if you have a dispute involving a purchase. You do not have to pay the bill for the disputed item. Instead, notify the credit card issuer by telephone immediately. The issuer must put the disputed amount on hold and send you a form to fill out explaining the dispute. The card issuer will attempt to resolve the dispute and inform you of the results. If the problem is not corrected and the credit card issuer brings suit, you may use as a defense the fact that unsatisfactory goods or services were received.

Another advantage of using a credit card arises if the card is stolen. You may have to pay up to $50 of **unauthorized** charges made before you notify the credit card issuer of the loss. You are not, however, responsible for charges made after the issuer has been notified.

Example Tara lost her credit card but did not notify the card issuer for a week. Meanwhile, someone who found the card had charged a purchase of $175 with it. Tara will have to pay $50 toward this unauthorized purchase. If she had notified the card issuer before the illegal purchase happened, however, she would not have had to pay anything.

Reading Check

Explain *Is it better to pay cash for electronic goods or buy them on credit?*

Student Loans

What can you do if you cannot afford to pay for college?

Education costs are on the rise and do not seem to be slowing down. For most people, going to college requires careful planning in order to pay the costs of tuition and basic living expenses.

A common way of financing your education is through student loans. There are two types of student loans, government loans and private loans.

Government Student Loans

The federal government is an enormous student loan lender. Under the Direct Loan Program, money is lent to students based on need. When a student applies to college, he or she fills out a FAFSA, or Free Application for Federal Student Aid. This application asks detailed information about the student and his or her family. The government then makes a determination about how much money it can loan the student. The figure is also based on the amount necessary to attend a specific college.

Legal Talk

Dispute: *v* To question the truth and validity. From Latin *disputare* = to examine.

Resolve: *v* To find a solution; to solve. From Latin *resolvere* = to untie.

Vocabulary Builder Look up the words *dispute* and *resolve* in the dictionary. Break them down into and define their root words.

Look It Up! Check definitions in *Black's Law Dictionary* or an online glossary. For direct links, go to **glencoe.com** to find more vocabulary resources.

Figure 11.2 Ways to Build and Protect Your Credit

- ☑ Open a checking or savings account, or both.
- ☑ Apply for a local department store credit card.
- ☑ Take out a small loan from your bank.
- ☑ Make payments on time.

Be aware that a creditor must:

1. Evaluate all applicants on the same basis.
2. Consider income from part-time employment.
3. Consider the payment history of all joint accounts, if this accurately reflects your credit history.
4. Disregard information on accounts if you can prove that it does not affect your ability or willingness to repay.

Be aware that a creditor cannot:

1. Refuse you individual credit in your own name if you are creditworthy.
2. Require your spouse to cosign a loan. Any creditworthy person can be your cosigner if one is required.
3. Ask about your family plans or assume that your income will be interrupted to have children.
4. Consider whether you have a telephone listing in your name.

Firm Foundation If you want a good credit rating, you must prove you can use credit wisely. ***Why is it a good idea to apply for a local department store credit card or a small loan from your bank?***

Within the Direct Loan Program, there are two types of government loans, **subsidized** and unsubsidized. If you receive a subsidized loan, the government pays the interest on the loan while you are in school. However, with an unsubsidized loan, the student remains responsible for the interest that accrues on the loan while in school. Under both loans, the student will pay interest on the loan after graduation. For more information visit the U.S. Department of Education Web site.

Private Student Loans

Private student loans are similar to other consumer loans. They are offered by banks across the country. The amount of money offered is based on the cost of tuition at your specific school. The interest rate on private loans is usually higher than on government loans, and students are responsible for the interest that accrues, even while the student is in school. Private education loans are also available to parents who want to take out loans to pay for their children's education.

Student Loan Repayment

Student loans in most circumstances must be repaid. There are a few exceptions. Student loans can be discharged in bankruptcy, but only in cases of extreme hardship. The government will discharge some or all of a student loan debt for students who enter special job programs after they graduate. These programs, such as AmeriCorps and the Peace Corps, usually require students to work in the health, education, or public safety field in an underdeveloped community for a certain period of time.

Warning Signs of Debt Problems

How can you tell if you have credit problems?

It is important to use credit wisely to build a good credit rating and to avoid getting heavily into debt early in life (see **Figure 11.2**). Here are some of the warning signs that you may be in financial trouble:

- You make only the minimum monthly payment on credit cards or have trouble paying even that much. The total balance on your credit cards increases every month.
- You miss loan payments or often pay late.
- You receive second or third payment due notices from creditors.
- You borrow money to pay off old debts.
- You exceed the credit limits on your credit cards.
- You have been denied credit because of a bad credit rating.

If you experience two or more of these warning signs, it is time to rethink your financial priorities.

After You Read

Summarize Identify the advantages and disadvantages of using credit.

Section 11.2 Assessment

Self Check

1. On what grounds can a seller be liable for selling a defective vehicle?
2. What can you do if you have a dispute involving a purchase on a credit card?
3. What is the difference between a subsidized and an unsubsidized student loan?

Academic Connection

Mathematics You want to buy a used car from a dealer for $8,400. The dealer requires a 20% down payment and you will have to finance the rest with a car loan. Use two different methods to figure out how much you will have to finance.

CONCEPT Problem Solving: Use a Variety of Appropriate Strategies to Solve Problems One method is to multiply the percent of the down payment by the total cost to find out the amount of the down payment. Then subtract the amount of the down payment from the total cost. Another method is to subtract the percent of the down payment from 100% to find out the percent of the amount you will have to finance, then multiply that by the total cost of the car.

Math For more math practice, go to the Math Appendix.

Critical Thinking

Disadvantages of Credit Advantages of using credit are that it is convenient, you can pay for expensive items over time, and it contributes to the growth of the economy. What are some of the disadvantages of using credit?

Go to **glencoe.com** to check your answers.

Chapter 11 Review and Assessment

Summary

Section 11.1 Understanding Credit

- Open-end credit is credit that can be increased by continuing to purchase goods or services on credit. Closed-end credit is credit given for a specific amount of money.
- A secured loan is a loan which is backed up by property, called collateral, that the creditor can take if the loan is not repaid.
- A security interest is created by the creditor possessing the collateral for a loan, or by the debtor signing a security agreement that identifies the collateral.
- The main types of collateral are consumer goods, fixtures, equipment, inventory, and farm products.

Section 11.2 Credit and You

- Before you sign any documents to buy a vehicle, you should know the exact price you are paying, the amount you are financing, the finance charge, the APR, the number and amount of payments, and the total sales price.
- When you use a credit card, you are borrowing money. You can go deeply into debt, even bankrupt, if you do not use your credit card carefully.
- There are both government and private loans available to students. To apply for government student loans, students fill out a FAFSA, or Free Application for Federal Student Aid.

Vocabulary Builder

1 On a sheet of paper, use each of these terms in a sentence.

Key Terms

- credit
- creditor
- debtor
- interest
- secured loan
- collateral
- security interest
- default
- finance charge
- annual percentage rate (APR)

Academic Vocabulary

- assets
- acquired
- effective
- involved
- unauthorized
- subsidized

Go to **glencoe.com** to play a game and improve your legal vocabulary.

Chapter 11 Review and Assessment

Key Points Review

Answer the following questions. Refer to the chapter for additional reinforcement.

2. What is the difference between open-end credit and closed-end credit?
3. What is a secured loan?
4. What are the three ways a security interest is attached?
5. What is the difference between a guarantor and a surety?
6. What are the six things you need to know before you sign a document to buy a vehicle?
7. What are a finance charge and an APR?
8. What are some advantages to using a credit card?
9. What are the different types of government loans available to students?

Standardized Test Practice

10. **Read the following excerpt from the Federal Reserve Board on how to use your credit card and complete questions 1 and 2.**

The first step in choosing a credit card is thinking about how you will use it.

- If you expect to always pay your monthly bill in full (and other features such as frequent flyer miles don't interest you) your best choice may be a card that has no annual fee and offers a longer grace period.
- If you sometimes carry over a balance from month to month, you may be more interested in a card that carries a lower interest rate (stated as an annual percentage rate, or APR).
- If you expect to use your card to get cash advances, you'll want to look for a card that carries a lower APR and lower fees on cash advances. Some cards charge a higher APR for cash advances than for purchases.

1. When you choose a credit card, you should be more concerned about

A. the credit card features
B. who the credit card issuer is
C. what the credit limit is
D. what the interest rate is

2. If you expect to pay your credit card bill in full every month, you should choose a credit card that offers a

A. lower fee for purchases
B. lower cash advance fee
C. longer grace period
D. lower interest rate

Test-Taking Strategies Formulate your own answer before reading the options when answering multiple-choice questions.

Apply and Debate

Read the following scenarios. Get together with other students in pairs or groups of three and take a position on each scenario. Debate your position in class with students taking the opposite position or prepare a written argument justifying your position.

11 Collateral

Wilson purchased a used computer from Jana for $400. He did not know that Jana had purchased the computer through a loan company and had not been making her payments on time. The loan company decided to repossess the computer.

You Debate *Can the loan company repossess the computer from Wilson?*

12 Lemon Laws

Tomas purchased a new car from a local dealer. Within two months he began to have several minor mechanical problems. Although the repairs were not major, Tomas felt that since there were so many of them, the car fell under the lemon law.

You Debate *Is Tomas entitled to get his money back for the car?*

13 Credit Cards

Quinton, a seventeen-year-old college freshman, was offered a credit card and accepted. He quickly ran up charges until he was unable to afford the payments. Just prior to his eighteenth birthday he attempted to get out of his contract with the credit card company because he was a minor when he received the credit card.

You Debate *Can Quinton get out of his debt with the credit card company?*

14 Credit Limit

Travis has reached the limit on his credit card and cannot make the monthly payments. He receives an offer in the mail for another credit card and is considering getting the other card to pay off some of the debt on his current card.

You Debate *Should Travis use the second card to pay off some of the first card?*

15 Student Loans

Levar was accepted to the college of his choice but did not qualify for a grant or scholarship. He makes money working a part-time job, but not enough to pay for all his expenses. He can cover the rest by taking out a student loan, which he will have to pay back later, or by using his credit card, which he can pay off on a monthly basis.

You Debate *Is Levar better off taking out a student loan or using his credit card?*

Case Study Practice – Patzka v. Viterbo College

16 **The Price of Credit** Mariann Patzka was enrolled at Viterbo College in Wisconsin. She incurred debt in the amount of $3,530.16 during her first semester. At that time, Ms. Patzka was not informed of any fees she could be charged if she did not pay in full by the first day of classes. Interest charges came to $2,253.55, making the total amount due $5,783.71. Ms. Patzka paid $1,509.55 to Viterbo College, but still owed $4,274.16.

Viterbo College assigned the debt to a collection agency, Security Credit. Prior to doing so, the College assessed Ms. Patzka a collection fee of 33% ($1,410.47), making the total amount due $5,684.63. Ms. Patzka made payments to Security Credit in the amount of $4,284.63. Ms. Patzka now argues that she does not owe the remaining $1,400 because her account was an open-end credit account and she was never informed of the potential charges and fees when credit was extended as required under the Federal Fair Debt Collection Practices Act.

Source: Patzka v. Viterbo College, 917 F.Supp.654 (W.D. Wis. 1996)

Practice Does Ms. Patzka need to pay the remaining $1,400?

17 Ethics Application

Breach of Trust? Arjang's parents gave him a credit card to use for textbooks, supplies, and in case of an emergency. When he was short of cash, he used the credit card to buy a new computer game at the campus bookstore. Since the purchase would show up as computer software, his parents would assume the purchase was a required school supply and he would not have to ask their permission.

- Was Arjang's purchase of the computer game without his parent's permission ethical? Why or why not?

18 Internet Application

Find out about Student Loans You do not have the money to pay for college tuition and books. You need to apply for a federal student loan. You have many options of student loans to choose from, so you must research what the right student loan for you is and prepare the student application.

Go to **glencoe.com** to access the Web site sponsored by Nellie Mae, select the right loan for you, download a blank application, and fill it out.

Reading Connection

Outside Reading Go to **glencoe.com** for a list of reading suggestions on student loans.

Chapter 12

Credit Protection and Bankruptcy

BusinessWeek News

A Business Rife with Bad Guys

By Amy Borrus

The new bankruptcy law imposes two requirements on anyone seeking to reduce or eliminate debt through the courts. To file for Chapter 7 or Chapter 13, you must have had a credit-counseling briefing within the prior six months. Once you file, you can't walk away from debts without first completing an instructional course on personal financial management.

The provisions are intended to curb bankruptcies by helping people work out a plan to pay back what they owe and better manage their finances. But the rules will send hundreds of thousands of people into a minefield where legitimate counseling agencies do business alongside unsavory players. "In this industry the good players are the exception, not the rule," says Eric Friedman, chief of the Montgomery County, Maryland, Consumer Affairs Division.

Flex Your Reading

Efficient critical reading involves being flexible with speed and comprehension. There are several ways of reading critically, and you need to fit a reading style to your needs and to the material.

Go to **glencoe.com** for Flex Your Reading activities, more information on reading strategies for this chapter, and guided practice in reading about bankruptcy laws.

Running up Bills Americans have a big problem managing debt. ***What is the average amount of credit card debt per household in the United States?***

SECTION 12.1 Credit Protection Laws

What You'll Learn

- Define repossession and garnishment.
- Describe the federal laws that regulate consumer credit.
- Discuss your rights under the Consumer Credit Protection Act, the Fair Credit Reporting Act, and the Fair Credit Billing Act.
- Explain the purpose of the Equal Credit Opportunity Act and the Fair Debt Collection Practices Act.

Why It's Important

You need to know the laws that protect you from creditors when you borrow money or use credit.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Social Studies (NCSS 2) Study the ways human beings view themselves in and over time.

English Language Arts (NCTE 6) Apply knowledge of language structure, language conventions, media techniques, figurative language, and genre to create, critique, and discuss print and non-print texts.

Reading Guide

Before You Read

Connect Have you ever borrowed money from someone who tried to profit from your situation?

Focus on Ideas

The federal and state legal systems protect your rights as a credit user.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.

Federal Laws Protecting Debtors

Consumer Credit Protection Act					

Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- repossession
- garnishment
- usury law
- Consumer Credit Protection Act
- Fair Credit Reporting Act
- Equal Credit Opportunity Act (ECOA)
- Fair Debt Collection Practices Act (FDCPA)
- Fair Credit Billing Act

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- dominant
- exceed
- impersonate

Laws Protecting Creditors

What can creditors do if you owe them money?

Historically, creditors have not needed special laws to protect them. They lend money or extend credit, and have the right to be paid back with interest. In their relations with debtors, creditors are the **dominant** parties. They are in a better position to control the terms of a transaction.

As You Read

Predict Can a finance company take your car away from you for not making the monthly payments?

Repossession

When a debtor borrows money or uses credit to buy property such as a car or refrigerator, the creditor places a legal claim on the property called a lien. **Repossession is when a creditor reclaims property on which it has a lien if the debtor does not make payment.** Repossession must be done without causing a disturbance. If the debtor refuses to surrender the goods, legal process must be used to obtain them.

After repossessing goods, secured parties may keep them (with exceptions) or sell them. Sales may be public auctions or private sales. If the goods are consumer goods for which the debtor has paid 60 percent or more of the price, the secured party cannot keep them—they must be sold. The debtor must be notified and is entitled to receive any surplus of the sale after debts and expenses have been paid.

Vocabulary You can find vocabulary definitions in the **Key Terms** glossary and **Academic Vocabulary** glossary in the back of this book.

Garnishment of Wages

If a debtor defaults on a loan, creditors also have the right to garnish their wages. **Garnishment is the legal procedure through which a worker's earnings are withheld for payment of a debt.** Garnishment of a worker's wages cannot **exceed** 25 percent of weekly take-home pay, except for certain amounts of support payments and taxes.

Repossession Creditors have a right to repossess property when a debtor defaults on a loan. ***What does a creditor need in order to claim property?***

Legal Talk

Entitle: *v* To furnish with a right or claim to something. From Latin *intitulare; in* = provide with + *titulus* = title: to give a name or title to.

Discriminate: *v* To make distinctions on the basis of class or category without regard to individual merit; show preference or prejudice. From Latin *discriminare* = to distinguish between.

Vocabulary Builder List and define five words that begin with the prefix *en,* where *en* has the meaning of "to be in something."

Look It Up! Check definitions in *Black's Law Dictionary* or an online glossary. For direct links, go to **glencoe.com** to find more vocabulary resources.

Laws Protecting Debtors

What rights do you have when you borrow money or use credit?

To protect consumers, both the federal and state governments regulate the credit industry. Most states, for example, have set a maximum amount that can be charged for interest. **A usury law is a law restricting the amount of interest that can be charged.** Other laws created by the federal government to protect debtors include the Consumer Credit Protection Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the Fair Debt Collection Practices Act, and the Fair Credit Billing Act.

Consumer Credit Protection Act

The Consumer Credit Protection Act, also known as the Truth in Lending Law, is a federal law that requires creditors to inform consumers of the costs and terms of credit. Creditors must tell you both the finance charge and the annual percentage rate (APR) of a loan. With this information you can compare the costs of loans from different lenders.

> **Example** When shopping for a truck, Carmen asked each dealer she visited what the APR would be to finance the purchase. The first dealer said 7.9 percent, another dealer quoted 8.2 percent, and her bank said that it would be 12 percent. Carmen went back to the first dealer, confident that she had found the best deal when shopping around for credit.

Fair Credit Reporting Act

The Fair Credit Reporting Act is a federal law that grants people the right to know what is contained in their credit reports. You have the right to know all personal information that is in a credit reporting agency's files and the sources of that information.

The three national credit reporting agencies in the United States are:

- Equifax
- Trans Union
- Experian

Under recent federal legislation, every person has a right to receive one copy of his or her credit report for free every year from each of the three credit reporting agencies. To find out more, visit the government's official Web site about annual credit reports.

You also have the right to be told the name of anyone who received a copy of your credit report in the past year (and in the past two years if the credit report relates to a job application). You may correct errors in the report. If the credit reporting agency retains information that you believe is inaccurate, your version of the facts must be inserted in the file.

Reading Check

Analyze *Why is it important to find out what is in your credit report?*

CYBERLAW

In re MasterCard International, Inc., et al.

132 F.Supp.2d 468 (E.D. La. 2001)

Larry Thompson and Lawrence Bradley filed a class action lawsuit against various banking companies and Internet gambling sites. They argued that the companies had entered into agreements that were illegal under the Racketeer Influenced and Corrupt Organizations Act (RICO) and the Federal Wire Act. Thompson and Bradley argued that Internet gambling is illegal in the United States and that because credit card companies such as MasterCard and Visa allowed customers to use their credit cards to buy gambling chips on foreign Internet gambling Web sites, the American banks were committing illegal racketeering activities. The foreign Web sites included graphics of the MasterCard and Visa logos on their sites. Thompson and Bradley argued that they were charged outrageous fees by MasterCard and Visa when they used their credit cards on these gambling sites.

Ruling and Resolution

The Federal District Court in Louisiana held that the RICO Act did not apply to this case. Although Internet gambling may be illegal in the U.S., the Web sites were all foreign and the Federal Wire Act only prohibits Internet gambling on sporting events, not on other types of gambling. Therefore, the banks could not be sued under the RICO Act.

Critical Thinking Should the Federal Wire Act be amended to prohibit all Internet gambling?

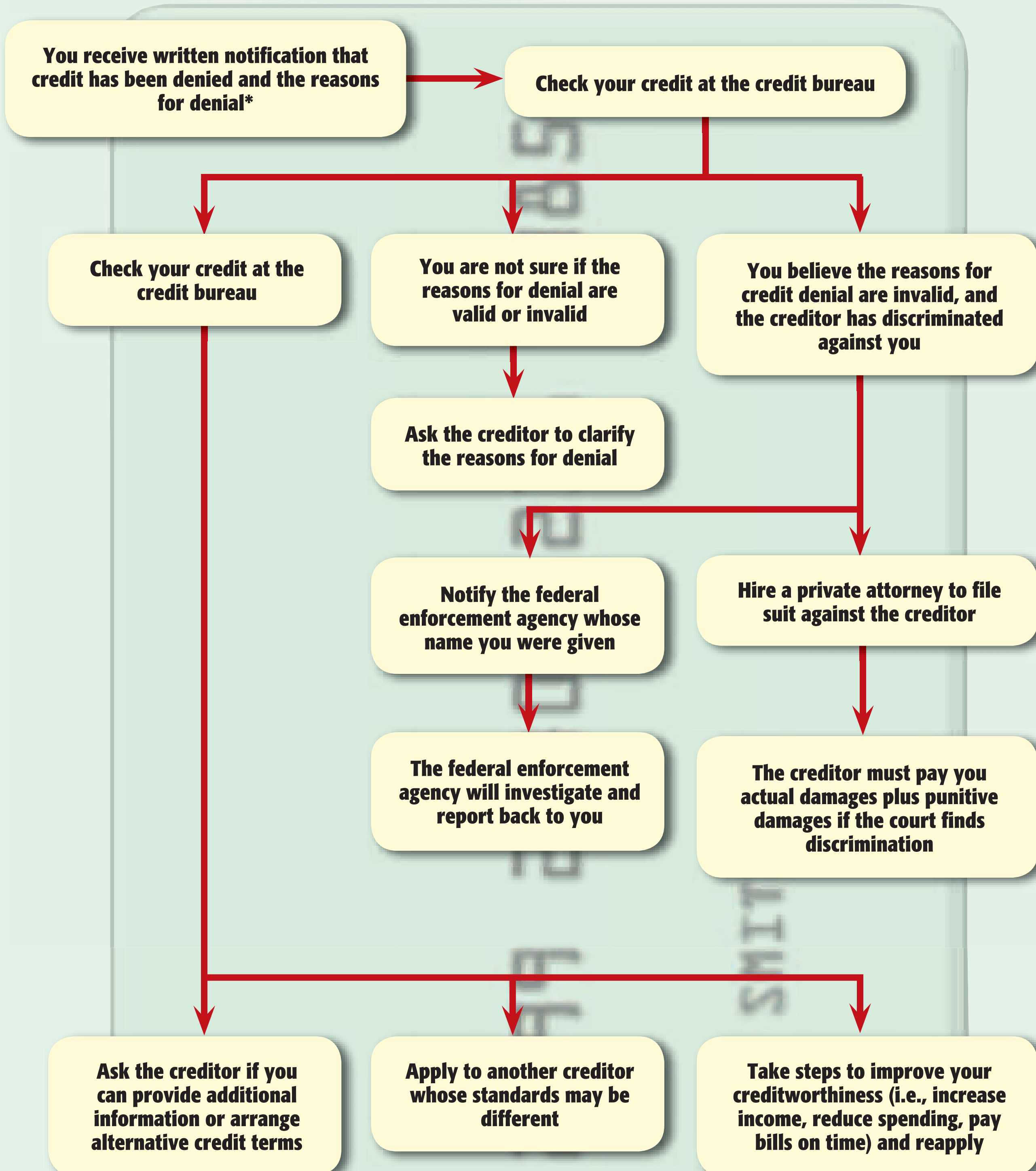
Equal Credit Opportunity Act

The Equal Credit Opportunity Act (ECOA) makes it illegal for banks and businesses to discriminate against credit applicants on the basis of their gender, race, marital status, national origin, religion, age, or because they get public assistance income. There are only three reasons a creditor may deny credit: low income; large current debts; and a poor record of making payments in the past. If you are denied credit, under the ECOA you have the right to know why (see **Figure 12.1** on page 268). If it is due to information in your credit report, you have a right to receive a copy of the report for free. If you find inaccurate or incomplete information in the report, you have the right to dispute it and have it corrected.

Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act (FDCPA) prohibits certain practices by debt collectors. The FDCPA makes it illegal for debt collectors to threaten debtors with violence, use obscene language, or contact consumers by telephone at inconvenient times or places. Debt collectors are not allowed to **impersonate** government officials or attorneys, obtain information under false pretenses, or collect more than is legally owed. They must identify themselves, tell why they are calling you, and cannot tell anyone else about the debt.

Figure 12.1 What If You Are Denied Credit?



*If a creditor receives no more than 150 applications during a calendar year, the disclosures may be oral.

Source: The Federal Trade Commission.

Sometimes you can be denied credit because of information from a credit report. The law requires credit card companies to correct inaccurate or incomplete information in your credit report. ***Why would it be better to request changes of incorrect information by letter rather than by phone?***

Fair Credit Billing Act

The Fair Credit Billing Act requires creditors to correct billing errors brought to their attention. When errors are made in bills sent by credit card companies and businesses that give credit, this law can help you. If you believe an error has been made, notify the creditor in writing within 60 days of the date of the statement. State your name, account number, the charge in question, and why you believe there is an error. The creditor must acknowledge your letter within 30 days. Also, the creditor must investigate and explain why the charge is correct or fix the mistake within 90 days. You do not have to pay the amount in dispute while waiting for an answer from the creditor, but you must pay all charges not in dispute. Creditors may not report you as being delinquent because of the disputed charge.

Credit Repair Organizations

Credit repair companies that promise they will fix your credit are not allowed to charge you until their services have been performed. They also must tell you about your legal rights. They must provide a written contract that details what services are to be performed, how long it will take, the total cost of the service, and any guarantees that are offered. The contract must also tell you that you have a three-day grace period to cancel the service at no charge.

After You Read

Summarize Name the federal laws that regulate consumer credit.

Section 12.1 Assessment

Self Check

1. What are two things creditors can do if a debtor defaults on a debt?
2. Under the Consumer Credit Protection Act, what must creditors tell consumers?
3. What are debt collectors prohibited from doing under the FDCPA?

Academic Connection

Social Studies Usury is lending money at an outrageous rate of interest. The practice of usury goes back at least four thousand years and originally meant simply charging interest. Even then, charging interest of any kind was considered immoral. It was prohibited by Chinese and Hindu law and frowned upon by the ancient Greeks. As the need to use credit to conduct business increased, however, the meaning of the word changed. It became acceptable for lenders to charge a reasonable rate of interest on loans so they could make a profit. In 1545, the British government set a maximum rate of interest that could be legally charged, and anything over that was considered usury. This practice was followed by most of the other European countries and later, the United States.

Research and write an outline on the historical development of usury or the attitude toward usury in different cultures.

Critical Thinking

Credit Protection Why do you think debtors need laws to protect them from creditors?

Go to **glencoe.com** to check your answers.

SECTION 12.2 Bankruptcy Laws

What You'll Learn

- Identify and discuss alternatives to bankruptcy.
- Distinguish between the different types of bankruptcy.
- Explain the difference between voluntary and involuntary bankruptcy.
- Identify debts which cannot be discharged by bankruptcy.

Why It's Important

You will need to know the laws about bankruptcy if you ever find yourself unable to pay off your debts.

Academic Standards

Reading and completing the activities in this section will help you practice the following academic standards:

Math (NCTM PSS 1)
Build new mathematical knowledge through problem solving.

Social Studies (NCSS 9)
Study global connections and interdependence.

Reading Guide

Before You Read

Connect Have you ever owed money and had no way of paying it back?

Focus on Ideas

Federal law provides the process for erasing your debts and restoring your credit.

Take Notes

Create a graph like the one shown and use it to take notes as you read this section. Go to glencoe.com to find graphic organizers and tips on how to improve your note-taking skills.

Types of Bankruptcy → **Personal** → / →
Types of Bankruptcy → **Business** → / →

Key Terms

You will learn these legal words and expressions in this chapter. You can also find these terms in *Black's Law Dictionary* or in an online legal dictionary.

- bankruptcy
- voluntary bankruptcy
- involuntary bankruptcy
- Chapter 7 bankruptcy
- Chapter 11 bankruptcy
- Chapter 12 bankruptcy
- Chapter 13 bankruptcy

Academic Vocabulary

You will find these words in your readings and in your tests. Look them up in a dictionary and familiarize yourself with them.

- alternative
- petition
- discharge

Bankruptcy

What can you do to avoid bankruptcy?

Sometimes people and businesses accumulate so much debt through no fault of their own that they can no longer afford to repay it. A business might suffer from a slump in the economy or be hit by a natural disaster. An individual might run up huge credit card debts because of a catastrophic illness and lack of medical insurance or simply by losing his or her job.

In the past, under old English law, people who could not pay their debts were put into debtor's prisons. The drafters of the U.S. Constitution opposed this treatment of debtors and gave Congress the authority to help people in this situation by enacting the bankruptcy law.

Bankruptcy is the legal process by which a debtor can make a fresh start through the sale of assets to pay off creditors. Certain bankruptcy proceedings allow a debtor to stay in business and use the revenue collected to pay his or her debt. Another purpose of bankruptcy law is to allow some debtors to free themselves from the debt they have accumulated, after their assets are distributed, even if their debts have not been paid in full.

As You Read

Predict Can you keep your business if you go bankrupt?

Case Study – In re McMullen Oil Co.

Critical Thinking *Did McMullen Oil deceive the bankruptcy law rules?*

Flex Your Reading Note key facts in the text below and look up words you do not understand. Restate difficult ideas in your own words. Go back and reread the text quickly to make sure you did not miss any important detail. Now, you are ready to formulate an opinion.

Stashed Checks On March 1, 1995, McMullen Oil Co. filed for bankruptcy. Under the requirements of bankruptcy law, the bank accounts of McMullen Oil at Comerica Bank were frozen, and no monies were allowed to be deposited into or taken out of the account. However, McMullen Oil also kept an account with Comerica that was solely used by McMullen's Pension Plan. Because the Pension Plan was a distinct business entity from McMullen Oil, that account did not need to be frozen.

Andrew Hopwood was the President of McMullen Oil. After March 1, 1995, he received ten checks payable to McMullen Oil, totaling $67,000. Mr. Hopwood took those checks and deposited them into the McMullen Pension Plan account, without an indorsement by McMullen Oil. Comerica Bank accepted those checks and deposited the funds into the McMullen Pension Plan account.

During the bankruptcy proceedings, the drawers of the ten checks realized what had happened and sued Comerica for a reimbursement, but that money had already been deposited into the account of McMullen Pension Plan.

In re McMullen Oil Co., 251 B.R. 558 (Bankr. C.D. Cal. 2000)

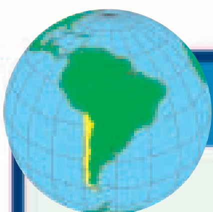
Go to **glencoe.com** for more case study practice.

Avoiding Bankruptcy

If you are having trouble paying your bills, you should immediately stop using a credit card and switch to a debit card. As an **alternative** to bankruptcy, you can contact your creditors and work out an adjusted repayment plan. Another possible solution is to get a consolidation loan, which combines all your debts into one loan with lower payments. For example, you can combine monthly payments on credit cards, student loans, and a car into one lower monthly payment.

You can also contact a nonprofit financial counseling program. The Consumer Credit Counseling Service (CCCS) is a nonprofit organization affiliated with the National Foundation for Consumer Credit. Local branches of the CCCS provide debt-counseling services. Check the white pages of your telephone directory, the Internet, or call 1-800-388-2227. All information is kept confidential.

Vocabulary You can find vocabulary definitions in the **Key Terms** glossary and **Academic Vocabulary** glossary in the back of this book.



Global Law

Chilean Bankruptcy Law

Chile's original bankruptcy law was passed in 1931 and served the country for more than 50 years. In the 1980s the country decided to reform its bankruptcy laws. Chilean Law Number 18,175 of the Commercial Code went into effect in 1982.

The Chilean legal system follows the French civil system when it comes to bankruptcy. The bankruptcy laws apply to both businesses and individual persons. There are three specific conditions under which a debtor can be declared bankrupt.

1. Default: a qualified debtor is no longer making payments to its creditor
2. Pending Executions (Titulo Ejecutivo): a debtor has three or more outstanding contracts and cannot pay at least two of them
3. Fugitive Debtor: a debtor leaves Chile as a fugitive

There are also two types of debtors in Chile: qualified and not qualified. A qualified debtor only applies to those debtors engaged in commercial, manufacturing, mining, or agricultural activities. Qualified debtors are allowed to begin bankruptcy proceedings on their own behalf. Not qualified debtors can only have bankruptcy proceedings brought against them by their creditors. Individual persons are not qualified debtors.

Qualified debtors may also be subject to criminal proceedings to determine whether the debtor is claiming bankruptcy because of criminal or negligent acts. A qualified debtor has only 15 days to file for bankruptcy, once it becomes clear that it is bankrupt. Failure to file within 15 days is a criminal offense and the debtor is held criminally liable for the bankruptcy.

Once bankruptcy is determined, the debtor's assets are immediately liquidated so that creditors may be paid. However, some qualified debtors are allowed to continue to operate so that the entire business may be sold, rather than breaking up the business.

Across Cultures: Receipts

Whenever you buy something in Chile, you will always get a receipt. It is against the law in Chile to sell something and not give a receipt.

Critical Thinking ***Is it fair that you can be declared bankrupt if you just stop paying your bills?***

Filing for Bankruptcy

The moment a **petition** for bankruptcy is filed, an automatic stay goes into effect. An automatic stay is a postponement of collection proceedings against the debtor. Further efforts by creditors against the debtor to collect debts must stop immediately. Creditors, such as credit card companies and lenders of unsecured revolving loans, cannot bring suit for what is owed them. Debit cards can no longer be used because any money in the debtor's bank belongs automatically to the bankruptcy trustee. However, lawsuits involving evictions, divorces, and child custody and support proceedings may continue.

Personal Bankruptcy An individual might need to declare personal bankruptcy because of running up huge medical bills with no medical insurance. *What kinds of bankruptcy can an individual petition for?*

Types of Bankruptcy

What property are you allowed to keep if you declare bankruptcy?

Bankruptcy can be voluntary or involuntary. **Voluntary bankruptcy is when the debtor files for bankruptcy to eliminate or reduce the burden of debt. Involuntary bankruptcy is when creditors begin the proceeding instead of the debtor.** Three creditors must file the petition for bankruptcy if the debtor has 12 or more creditors. The combined debt owed to the three must exceed $11,625. A single creditor who is owed a debt of more than $11,625 can also file if the debtor has fewer than 12 creditors.

Bankruptcy law is federal statutory law contained in Title 11 of the United States Code. There are four main kinds of bankruptcy proceedings. They are named for the chapter of the federal Bankruptcy Code that describes them.

Chapter 7 Bankruptcy (Liquidation)

Chapter 7 bankruptcy, also called ordinary bankruptcy, is a type of bankruptcy which allows individual debtors to discharge all their debts and get a fresh start. With this form of bankruptcy, debtors must sell most of their property and pay their creditors from the proceeds. Debtors must also do the following:

- Get credit counseling from a nonprofit agency before filing for bankruptcy.
- Have a family income below the state's average family income. (If the income is greater, a debtor may be able to file Chapter 13 bankruptcy.)

Business Bankruptcy
A business might need to declare bankruptcy due to a natural disaster. *What should businesses do to avoid such problems?*

- Provide a federal tax return for the most recent tax year.
- Complete a course in financial management after filing for bankruptcy.

As part of the fresh start policy of the Bankruptcy Act, some assets can be kept by the debtor. These so-called exemptions can be doubled for married couples filing jointly. Depending on your state law, you use either your own state exemptions or the federal ones.

Chapter 11 Bankruptcy (Reorganization)

Chapter 11 bankruptcy is a type of bankruptcy that allows businesses to reorganize their financial affairs and still remain in business. When a petition is filed, a reorganization plan for the business is developed. Once the plan is approved by a certain number of creditors and the court, it will go into operation. If the plan is successful, the business will continue. If not, it will be forced to close.

Chapter 12 Bankruptcy (Family Farmers)

Chapter 12 bankruptcy is a form of bankruptcy that lets family farmers, and fishing businesses, create a plan for debt repayment that allows them to keep their operations running. They must receive more than one-half of their total income from farming or fishing. Also, 50 percent of the debt must result from farm or fishing expenses.

Chapter 13 Bankruptcy (Repayment Plan)

Chapter 13 bankruptcy is a form of bankruptcy that permits individual debtors to reorganize their debts and develop repayment plans. During the period of repayment (three to five years) creditors may not continue collection activities. People who have too much income to file for Chapter 7 bankruptcy may file for Chapter 13. This can be done only if they can make debt repayments of $100 a month for five years. Debtors who wish to keep their car must pay the full loan amount on car loans.

Reading Check

Analyze *Which types of bankruptcy apply to individuals and which types apply to businesses?*

Exceptions to Discharge

Some debts cannot be **discharged** by bankruptcy. That means you still have to pay them even if you qualify for bankruptcy.

These include debts caused by the debtor's fraud, back taxes, and student loans that do not impose a hardship on the debtor.

Administration of the Debtor's Estate

Following a court hearing, a trustee will be appointed to sell the debtor's property, or estate, to obtain cash. The trustee then distributes the cash among the debtor's creditors according to a priority list. Secured debts are paid first, followed by administrative costs, wages, benefit plans, alimony and support, taxes, and unsecured debts.

Restoring Credit after Bankruptcy

Can you still get credit after you have declared bankruptcy?

A bankruptcy filing remains on a debtor's credit report for ten years and has a bad effect on obtaining a line of credit. However, most debtors who file bankruptcy already have a poor credit rating anyway, and bankruptcy gives them a chance to begin anew. Many of their debts become discharged, which improves their debt-to-income ratio—a factor that creditors look at carefully. The more time that elapses after the bankruptcy filing, the easier it is to reestablish credit.

After a bankruptcy, debtors must educate themselves on developing a budget, managing their money, and using credit and debit cards wisely to avoid accumulating debt again that they cannot resolve.

After You Read

Summarize What are the four main types of bankruptcy?

Section 12.2 Assessment

Self Check

1. What are some alternatives to bankruptcy?
2. What are the differences between voluntary and involuntary bankruptcy?
3. What is the difference between declaring Chapter 7 and Chapter 13 bankruptcy?

Academic Connection

Mathematics You applied for a loan. The lender tells you that you will get a better rate if your debt payments-to-income ratio is low. If your monthly income is $1,200 and your monthly debt payments total $180, what is your debt-payments-to-income ratio (DPR)?

CONCEPT **Number and Operations:** To figure out a ratio, you need to use a fraction. To calculate the DPR ratio, divide the total debts by the total income.Convert the decimal outcome to a percentage by moving the decimal point two places to the right and adding a percent sign (%).

Math For more math practice, go to the Math Appendix.

Critical Thinking

Debt Burden How much money do you think someone should owe before declaring bankruptcy?

Go to **glencoe.com** to check your answers.

Chapter 12 Review and Assessment

Summary

Section 12.1 Credit Protection Laws

- If a debtor fails to make payments, the creditor has a right to repossess property or garnish the person's wages.
- The Consumer Credit Protection Act requires creditors to inform consumers of the costs and terms of credit.
- The Fair Credit Reporting Act grants people the right to know what is contained in their credit reports.
- The Equal Credit Opportunity Act (ECOA) makes it illegal to discriminate against credit applicants.
- The Fair Debt Collection Practices Act (FDCPA) prohibits certain practices by debt collectors.
- The Fair Credit Billing Act requires creditors to correct billing errors brought to their attention.

Section 12.2 Bankruptcy Laws

- Bankruptcy can be voluntary or involuntary.
- Chapter 7 bankruptcy allows individual debtors to discharge all their debts and get a fresh start.
- Chapter 11 bankruptcy allows businesses to reorganize their financial affairs and still remain in business.
- Chapter 12 bankruptcy allows family farmers and fishing businesses to repay debts and still keep their operations running.
- Chapter 13 bankruptcy is a form of bankruptcy that permits individual debtors to develop repayment plans.
- Debts that cannot be discharged by bankruptcy include debts caused by fraud, back taxes, and student loans.

Vocabulary Builder

1 On a sheet of paper, use each of these terms in a sentence.

Key Terms

- repossession
- garnishment
- usury law
- Consumer Credit Protection Act
- Fair Credit Reporting Act
- Equal Credit Opportunity Act (ECOA)
- Fair Debt Collection Practices Act (FDCPA)
- Fair Credit Billing Act
- bankruptcy
- voluntary bankruptcy
- involuntary bankruptcy
- Chapter 7 bankruptcy
- Chapter 11 bankruptcy
- Chapter 12 bankruptcy
- Chapter 13 bankruptcy

Academic Vocabulary

- dominant
- exceed
- impersonate
- alternative
- petition
- discharge

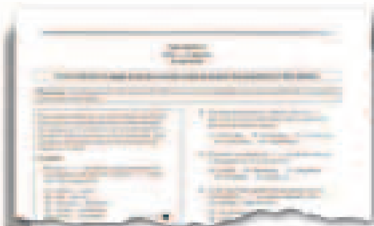
Go to **glencoe.com** to play a game and improve your legal vocabulary.

Chapter 12 Review and Assessment

Key Points Review

Answer the following questions. Refer to the chapter for additional reinforcement.

2. What is garnishment and what is the most a creditor can garnish?
3. What rights does the Fair Credit Reporting Act give people?
4. What are the only three reasons a creditor may deny credit?
5. According to the Fair Credit Billing Act, what should you do if you believe an error has been made on a bill?
6. What are the differences between Chapters 7, 11, 12, and 13 bankruptcies?
7. Which types of bankruptcy are personal and which are business bankruptcies?
8. How is a debtor's property distributed upon bankruptcy?
9. Which debts are not extinguished by bankruptcy?



Standardized Test Practice

10. **Read the following excerpt from the terms and conditions of a credit card and do problems 1 and 2.**

> **Default Rate:** All your APRs may increase if you default under any card agreement, if you fail to make a payment when due, you exceed your credit line, or you make a payment that is not honored. In these circumstances, we may automatically increase your interest rate on all balances to the default APR, which is equal to the prime rate plus 23.99% or up to 28.99%, whichever is greater.
>
> **Late Fee:** We add a late fee to each billing period if you fail to pay by the due date. This fee is based on your account balance as of the payment due date. The late fee is: $15 on a balance up to $100, $29 on balances of $100 to $250, and $39 on balances over $250.

1. If you default under a card agreement, your interest rate can be automatically increased to:

- A the prime rate
- B 23.99%
- C the prime rate plus 23.99% or up to 28.99%, whichever is greater
- D the prime rate plus 23.99% or up to 28.99%, whichever is lower

2. You make a late payment on a balance of $234. You will be charged a late fee of:

- A $15
- B $29
- C $100
- D $39

Test-Taking Strategies When trying to answer difficult questions, first eliminate answers you know are incorrect, then analyze the remaining answers.

Apply and Debate

Read the following scenarios. Get together with other students in pairs or groups of three and take a position on each scenario. Debate your position in class with students taking the opposite position or prepare a written argument justifying your position.

11 Repossession

Tamara purchased a car for $5,000 down and a four-year loan with payments of $400 per month. During the last year of her loan, she lost her job and fell behind in her payments. The bank repossessed her car, leaving Tamara with nothing.

You Debate *Can the bank sell Tamara's car for below-market value to settle her loan?*

12 Consumer Credit Protection Act

Jason was reviewing the loan documents he had just signed with a lender, who had quoted him the lowest interest rate. He noticed that his loan was increased by $2,000, which is the cost of points he had to pay for the low interest rate. The lender had not explained this to him.

You Debate *Is the lender violating the Consumer Credit Protection Act by not disclosing the additional costs to Jason?*

13 Fair Credit Billing Act

When Ned received his credit card bill, he noticed a charge he had not made. He notified his credit card company by phone, then in writing. After an investigation, the company determined that Ned would be held responsible for the complete charge.

You Debate *If Ned did not make this charge, should he be required to pay for it even after the investigation?*

14 Credit Repair Organizations

Maria contacted a credit repair company to help her with her credit. At the end of her meeting, Maria was asked to pay $450 in administrative costs.

You Debate *Is Maria required by law to pay the fee to the credit repair company?*

15 Chapter 7 Bankruptcy

The Mundy family has not been able to pay their debts since Hurricane Katrina struck their home and business. They decided to file for Chapter 7 bankruptcy to get relief from their creditors.

You Debate *Is bankruptcy the best option for the Mundy's considering the circumstances?*

Case Study Practice – Ardis v. Educational Management Corp.

⑯ Can Student Loans Be Discharged in Bankruptcy? In July 1991 Robert Ardis consolidated his student loans into one loan totaling $23,756. He made 14 payments totaling approximately $2,700 until August, 1994, when he stopped paying the loan. In April of 1995, his account went into default. Ten years later, in 2005, the amount, with interest, had increased to $70,600.

In 2005, Mr. Ardis sought to have his student loan debt discharged in bankruptcy. He had previously filed for bankruptcy in 1995 and 2003. Both times, the bankruptcy court declined to discharge his student loans. Mr. Ardis, a single father, worked as a teacher at an annual salary of $40,000 and did not anticipate any salary increases in the near future. His offer to pay a lump sum of $8,000 was rejected.

Student loan debt is not normally dischargeable in bankruptcy, but can be if the debtor demonstrates three things: 1) that the debtor could not maintain a minimal standard of living if forced to repay the loans; 2) that the debtor's financial situation is likely to persist into the future; and 3) the debtor has made good faith efforts to repay the loan.

Source: Ardis v. Educational Management Corp., 2006 WL 931563(D.S.C. 2006)

Practice Should Mr. Ardis's student loan debt be discharged?

⑰ Ethics Application

Student Loans Paul graduated from college with a business degree owing $20,000 in credit cards and personal loans. Two years after graduating, he is not making enough money to keep up with his debts and is considering filing for bankruptcy.

- Would it be unethical for Paul to declare bankruptcy under these circumstances?

⑱ Internet Application

Preventing Abuse The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 created major changes in the bankruptcy system. Under the new law, people who want to file for Chapter 7 bankruptcy must meet certain requirements.

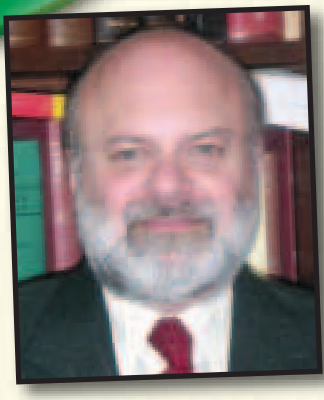
Go to **glencoe.com** to access the Web site FindLaw to read about the main changes in the bankruptcy law and write a brief description of them.

Reading Connection

Outside Reading Go to **glencoe.com** for a list of outside reading suggestions about credit and bankruptcy laws.

UNIT 4

Careers in Law



Ira A. Finkelstein

Attorney, Harnik & Finkelstein

What do you do at work?

"My primary area of legal practice entails representing sports organizations, leagues, teams, and athletes who are involved in legal disputes of many kinds. Sometimes the disputes involve disagreements over contracts such as athlete employment agreements, or contracts involving athletes' endorsements of products. Sometimes the disputes involve much more serious legal problems such as when someone is accused of violating an important rule of a sport, like not obeying a referee's decision, or cheating, or using prohibited substances to improve athletic performance."

What skills are most important to you?

"My ability to conduct a trial or hearing and, perhaps even more important, my ability to negotiate a settlement. Most sports disputes result in out-of-court settlements. It is also very important to me that I learn everything I can about the sport I am working with and the people who are involved in it."

What training do you recommend?

"Any good lawyer can become a good sports lawyer, because the basic legal skills and learning experiences are the same. However, lawyers who want to represent athletes or clubs in salary contract negotiations should have good training in employment negotiations. Since in so many sports the athletes are organized similar to labor unions, previous experience in labor relations law is a plus. I recommend that if you really love a particular sport, get involved at the local level of the sport initially to meet as many people as possible, and learn about all of the particular legal issues that the sport may involve."

What is your key to success?

"I believe in having a very close relationship of trust with my client. A lawyer's duty of confidentiality to a client is essential to establish trust and protect the client's interests."

Résumé Builder

Academic Skills

- Above average critical-thinking skills
- Good speaking and debating skills

Education and Training

A bachelor's degree in business administration, finance, sports and leisure science, or a basic legal background augmented with specific study of chosen industry or sport. The following high school and college courses will help develop the necessary background knowledge:

- Athletic administration (college)
- Athletic management (college)
- Business, contracts, and consumer law
- Business management
- English language arts (rhetoric and composition)
- Sports management (college)
- Sports marketing

Critical Thinking

Why does it benefit a negotiator to remain cool and calm while working on a deal?

Go to **glencoe.com** to find legal careers resources.

UNIT 4

The Writing Connection

Persuasive Writing Practice

Is It Legal Even in a Changed World? After the events of September 11, 2001, Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, also known as the U.S. Patriot Act. The new crimes of domestic terrorism became credible threats to the Homeland Security. The White House states that the Act "has been vital to winning the War on Terror and protecting the American people." President George W. Bush stated in a speech that the Act allows intelligence and law enforcement officials to continue to share information by using tools against terrorists; the intent is to ensure the nation's security while safeguarding the civil liberties of the people.

Assignments

Research Research what makes the U.S. Patriot Act controversial legislation.

Write After considering the situation above and conducting research, write a persuasive essay about your stance on the constitutionality of the Act.

Writing Tips Before you start writing your essay, read through the following prewriting techniques:

- ✓ Read newspaper archives on your specific subject. Pay attention to the different angles of the editorials. How do you respond to the different issues raised?
- ✓ Reading editorials may give you ideas for developing evidence towards your position in the essay.
- ✓ Create a graphic organizer to help you organize and visually show the plan for your argument.

Essay Test Strategies Keep your audience and purpose in mind:

- ✓ Audience: peers, classmates, and teacher
- ✓ Purpose: present an opinion, acknowledge alternative viewpoints, and provide reasons for your opinion

Go to **glencoe.com** to find more writing resources.

UNIT 4

Thematic Project

Correcting a Credit Report Error

For this project, you will use what you have learned to prepare a business letter disputing an error you have discovered on your credit report. For this project, you will work individually.

Here is a checklist of the skills that you will need to complete this project. Your teacher will consider these skills when evaluating your work.

Evaluation Rubric	
Academic Skills	
1. Online and library research	**1.** 10 points
2. Reading for information	**2.** 10 points
3. Note-taking	**3.** 5 points
4. Estimation and computation of facts/figures	**4.** 10 points
5. English composition to summarize findings	**5.** 15 points
Legal Skills	
6. Research of consumer reporting and credit rights	**6.** 15 points
7. Methods of comparing the three main credit bureaus' reports	**7.** 15 points
8. Analysis of the essential statistical information	**8.** 15 points
9. Use of technology	**9.** 5 points
	Total 100 Points

For more resources and for grading rubrics, go to **glencoe.com**.

Step 1: Preparation

1. Write an outline of a business letter to dispute an error you have discovered on your credit report.
2. Use all you have learned in this unit, at the library, or on the Internet as tools.
3. Complete this project in a format acceptable for an addition to your portfolio.

Step 2: Procedure

1. **Review** the text in this unit and make a list of essential tools to protect or repair your credit report. Go to **glencoe.com** to find additional resources for understanding credit reports based on the reporting agency.
2. **List** all the credit terms you might use in your business letter. What are you disputing in the report? What remedy are you expecting from the reporting bureau? What proof can you offer that the information is incorrect? How long will you allow the agency to rectify the error?
3. **Write** a standard business format letter, based on your knowledge and research, to one of the three credit report bureaus regarding a dispute on your credit report. Use the Internet to download a sample dispute letter, or create an original letter using word-processing software. Make enough copies of your letter to allow classmates to review and annotate.
4. **Describe** the scenario that is the basis for your dispute business letter and present your letter to the class.

Step 3: Create an Analysis Report

As a class, compare the letters presented. Generate a list of common areas that all letters included and what information could make it easier to resolve the conflict.

1. What formats of business letters were used to compose this assignment?
2. Did the letters include all the necessary elements to resolve the conflict?
3. If not, how does the absence of the element(s) affect the resolution?
4. How was your letter similar to or different from the other business letters presented?

Community Connection

Find the information on the number of judicial courts, judgeships, and number of districts in the United States. What steps are required in filing a bankruptcy? How are jurors selected to stand on bankruptcy hearings? Are there any special requirements to being a juror in a judicial court? Go to **glencoe.com** to find resources.

Competitive Event Prep

Establishing Credit

Situation: Assume the role of a high school business law student who recently turned 18. Since turning 18, you have received a great many offers from several credit card companies. The offers vary in the interest rates charged and incentives such as airline frequent flier miles and points for free hotel stays. You have learned the importance of establishing credit and maintaining a good credit rating. You would like to begin to establish credit in your name by opening a credit card account.

Activity: You are to discuss with your parents your credit card options. Your discussion should include some selection criteria and other factors to consider when choosing a credit card.

For more Competitive Event preparation, performance tips, and evaluation rubrics, go to **glencoe.com**.

UNIT 4

Landmark Case

Household Credit Services, Inc. v. Pfennig

United States Supreme Court 541 U.S. 232 (2004)

Read Critically **As you read this case, ask yourself the following questions:**

1. Why did Ms. Pfennig have to pay over-limit fees?
2. Does the Truth in Lending Act include a clear definition of finance charge?
3. Who is responsible for creating regulations under the Truth in Lending Act?
4. What does Regulation Z define?

Assignment **When you are done, write a short summary of the situation. Include the court's decision and a couple of sentences about why or how the court reached its decision.**

Facts **Consumer's Credit Card**

Sharon Pfennig had a credit card with a limit of $2,000. She originally had the card issued by Household Credit Services, Inc. However, after she received the card, Household Credit Services, Inc. sold its credit card business to MBNA America Bank, N.A. Although she had a credit limit of $2,000, Ms. Pfennig was able to make charges on her credit card that caused her to exceed the limit. For every month that Ms. Pfennig exceeded her credit limit, she was charged an over-limit fee of $29.

Class Action Suit On August 24, 1999, Ms. Pfennig filed a class action lawsuit against MBNA alleged on behalf of all consumers nationwide that they were charged or assessed over-limit fees on cards issued by MBNA. Ms. Pfennig alleged that MBNA allowed its customers to exceed its stated credit limits, thereby subjecting the customers to the over-limit fees. Ms. Pfennig further argued that the over-limit fees were "interest charges" under the Truth in Lending Act (TILA) and that MBNA, therefore, misrepresented "the true cost of credit" to its customers.

The Truth in Lending Act Congress passed the TILA as a means to encourage the "informed use of credit" by American consumers. In order to achieve those ends, the TILA requires that creditors include adequate disclosure in their documentation to ensure that all the relevant credit terms are meaningfully disclosed. Congress also gave expansive power to the Federal Reserve Board to enact appropriate and extensive regulations to ensure that Congress's intent in passing the TILA was followed by creditors.

Under the specific legislation, TILA requires that:

The credit card statement must include the account's outstanding balance at the end of the billing period and the amount of any finance charge added to the account during the period, itemized to show the amounts, if any due to the *application of percentage rates and the amount, if any imposed as a minimum or fixed charge. 15 U.S.C. §1637(b)*

A finance charge is an amount payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. 15 U.S.C. §1605(a)

Regulation Z Under the TILA, Congress gave the Federal Reserve power to enact regulations that include "classifications, differentiations, or other provisions, and [to] provide for such adjustments and exceptions for any class of transactions, as in the judgment of the [Federal Reserve] are necessary or proper to effectuate the purposes of [the TILA], to prevent circumvention or evasion thereof, or to facilitate compliance therewith." Regulation Z is one of those more specific regulations that seeks to further define finance charge. Regulation Z specifically excludes some fees from the definition of finance charge.

Regulation Z excludes, among other things, the following:

1. *Application fees charged to all applicants for credit, whether or not credit is actually extended.*
2. *Charges for actual unanticipated late payment, for exceeding a credit limit, or for delinquency, default, or similar occurrence.*
3. *Charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing.*
4. *Fees charged for participation in a credit plan, whether assessed on an annual or other periodic basis.*
5. *Seller's points.*
6. *Interest forfeited as a result of an interest reduction required by law on a time deposit used as security for an extension of credit.*
7. *Certain fees related to real estate.*
8. *Discounts offered to induce payment for a purchase by cash, check, or other means, as provided in section 167(b) of the Act.*

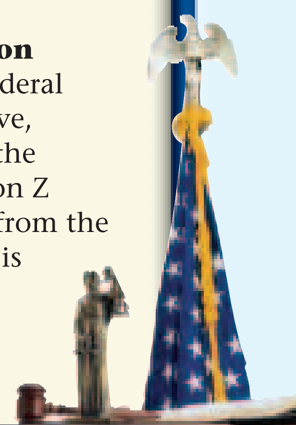
Opinion **Court of Appeals**

The Sixth Circuit Court of Appeals found that the TILA was ambiguous in its definition of finance charge. The Court reasoned that Ms. Pfennig only had to pay the over-limit fee because MBNA had chosen to extend her additional credit, thus allowing her to exceed her credit limit for a limited time. Therefore, the Court of Appeals held the MBNA might have violated the TILA and remanded the case to the Federal District Court.

Ambiguity Under the TILA, the definition of finance charge is ambiguous. Therefore, the Federal Reserve's regulation is binding on the courts, unless the regulation is "procedurally defective, arbitrary or capricious in substance, or manifestly contrary to the statute." The Supreme Court, thus, must determine whether Regulation Z falls under any of the above exclusions.

Holding **The Court's Decision**

The Supreme Court held that the Federal Reserve's Regulation Z is not defective, arbitrary, capricious, or contrary to the statute. Therefore, because Regulation Z specifically excludes over-limit fees from the definition of finance charge, MBNA is not liable to Ms. Pfennig for failing to meaningfully disclose all finance charges under the TILA.



TRIAL PREP

The National High School Mock Trial Association organizes competitions at the local, regional, and national levels where teams of high school or college students prepare and argue fictional legal cases before practicing attorneys and judges. Mock Trial team members are each assigned a role as either an attorney or witness. Each team must develop a courtroom strategy, legal arguments, and a presentation style.

Go to **glencoe.com** to find guided activities about case strategy and presentation.