

LECTURE #14 - DEBTOR AND CREDITOR RIGHTS

Today we're talking about the subject of creditors and their legal rights and Debtors and their legal rights. Creditors are the people who loan money, have money owed to them and are the source of credit and of capital and of money. Debtors are the people who owe the money. They are the people who must make payments or if they have collateral pledged, such as a home or condominium or automobile, they are going to lose their property if they do not pay the debt to their creditor. The creditors are interested in getting the debt paid. They don't really want the property. They want the money paid back because that's what they use their capital for. So this subject is debtor's rights and creditor's rights. I was not going to include it in my original list of subjects for the American legal system and American administrative law system because it's a subject that I used to consider boring since it was only about money, commerce, and business. But that was when I was young. As I've become older I've learned that the business of America is business. America is a strong country because of business and commerce and our legal system does a lot to protect creditors and make them able to lend money and give credit, and to protect the debtors so that they don't lose everything if they cannot pay their debts. That is where the subject of debtor's rights comes in to protect people's homes and their savings. And the third reason I included it in this subject is that I listened to an interview with a Russian woman, a famous actress who was married to an American for 10 years and lived in America for 10 years and then came back here recently in the last 1 or 2 years, and she was asked several questions about life in America. One of them was, "What is the biggest difference you've found in your 10 years of living in America between life in Russia and life in America?" She said, "Credit – Americans buy everything on credit. Many people have homes, the majority of people have cars, but they do not own them. They don't have the cash to purchase them, but they can borrow the money and make payments on those automobiles and on those homes and even on vacations and on furniture and consumer goods. That is because America has a very good credit system that will allow people to borrow money when they can prove they have jobs, and the credit bureau will verify they have jobs and that they make their payments. They can then live like they are wealthy just because they have jobs and a record of paying their debts. The result is that the credit system in America is enormous and makes a big difference between life in Russia and life in America."

Then in talking to a lecturer about Colombian law, I learned that in South America the same thing is true. People do not own their houses and do not own their automobiles unless they pay cash. They do not have a very developed credit system in most countries in South America – Argentina, Colombia Equador, Brazil. Even in Venezuela with all its oil, there is not an advanced credit system. So I thought I would try to give a summary of things that the American legal system does to encourage and help credit so that people can borrow, and to protect the debtors when they cannot pay it back. Interestingly, Americans can buy a lot of the consumer goods that we have, the televisions, computers, automobiles, pickup trucks, air conditioners, and heaters because of the one series of laws, that I am holding up here right now for you, called The Code. It's the closest thing we have to a code in America. It's called the Uniform Commercial Code. In it is the law

protecting banks allowing them to lend their money. It is the law protecting any lender, whether it's a bank or anyone lending money on an automobile, allowing papers to be signed and filed to give a Security Interest or a lien on an automobile or vehicle. And 3rd it governs the law of contracts for sales of goods. All these laws are in the Uniform Commercial Code, which isn't quite the same as a code as it's conceived of in Europe – the Code Napoleon or The Civil Law Codes. However, it is less subject to interpretations from state to state by judges as with other laws in the common law system. It is the one series of laws that we try to have that allows the creditors to be protected as well as the debtors to know exactly what their rights are and it does not vary by judicial interpretation or from state to state like most business and non-federal law in America.

Again, let me emphasize that institutions other than the legal system support the American credit system. Things like credit bureaus and credit ratings which are records of people's history of paying back their borrowed money are the backbone of the credit system. All people, when they go to borrow money must submit an application and the creditors, whether it's an automobile sales company, a furniture store, or a computer seller, all check on the internet with the Credit Bureau to see if that person has a record of paying his bills. If he has a good credit rating and pays his bills then he is likely to get the loan and be able to borrow the money to buy the goods. So he would only have to pay \$100 for \$1000 worth of computers and televisions and sign a promise to pay the other \$900 on a monthly basis. The existence of secure jobs becomes very important for these payments. The existence of banks where people keep bank accounts and people being able to verify that when someone says he has \$1,000 or \$5,000 in the bank that it is true – this is important. And credit cards – where else would someone be able to have a credit card and borrow so much money on credit cards as in America? We have billions of dollars in America on credit card debt. People charge everything from McDonalds' hamburgers to University tuition to University books on bank credit cards.

Let's look at what the legal system does to protect creditors, to allow them to be able to lend money to people on credit cards, to lend money to people to buy automobiles, to lend money to people to buy furniture and televisions, to lend money to people to buy computers, to lend money even to small businesses – a store that's going to sell lots of computers and televisions. How can they borrow money to be able to buy all the computers and televisions to have them there in the store? They often don't have the large amount of capital that's required to be able to get all those televisions and computers into the store that they then resell at a profit to all the individual consumers who want to buy them. The answer is in this Uniform Commercial Code, called the UCC. The UCC determines that a creditor may obtain a secured interest or a lien on goods such as televisions, computers, any kind of moveable property that people put a lien on and borrow money against and file it in a central recording place, usually in both the state capital and the county. A lien is the right to take the goods or property back and resell it to pay off the debt. It must be done peaceably or the creditor must go to court to do it. As a result, the store (the creditor) can then take a down payment of 10% or 20% of the money that is required and allow people to make monthly payments for 1, 2 or 3 years on the difference to be able to pay off the furniture, computer, and so forth. Credit cards are the same way. They depend on the non-legal system of credit bureaus that

obtain records of whether people have a history of paying debts and keep track of whether people pay on time and do they pay the monthly payment on their credit cards. They also depend on the legal system's ability to allow someone to go to court and obtain the equipment back, or obtain a judgment. A civil action to obtain a money judgment is one of the most important rights a creditor has. And what is it that a creditor gets when his lawyer wins a judgment? It's only a piece of paper, a Final Judgment in court. What do you do with that Final Judgment? I don't know what is done in Russia, but I suspect it is the same in every system because America inherited it from England which I'm sure inherited it from Europe, and it's the system of putting that paper called a Judgment in the hands of a sheriff, who is then instructed to go out and seize the goods and property and money and bank accounts of the debtor, the person who lost the lawsuit, and apply them to payment of the judgment. So a Writ of Execution is the paper you place in the hands of a sheriff. The reason people want a Mortgage when they loan people money on real estate is that they want to be sure that they are ahead of all the Judgments and other Liens.

Let's look at mortgage foreclosure which is the other important right of creditors that's very important in America. We will talk again about it tomorrow when we talk about real estate. If you look at tomorrow's Reading #25, you will see a large amount of paper – maybe over 100 pages of papers in a purchase of a \$177,000 condominium. The most important papers in there are a Promissory Note and a Mortgage that allow a person to borrow \$156,000 of that \$177,000 purchase price, so that he only needed \$23,000 cash. In fact not only did he borrow with this first Mortgage \$156,000, this buyer also borrowed with a second Mortgage another \$20,000, so that he actually only needed to come up with \$12,000 to buy a \$177,000 condominium. The way it's done is with mortgages that allow people to make payments of principal and interest for 30 years. You divide that \$144,000 borrowed into 30 times 12 months, 360 even payments with interest and the mortgage company makes the interest on \$150,000 or whatever it is and a person keeps making payments. If he doesn't make the payments – what is the penalty? The penalty is that the mortgage company can come in and foreclose the mortgage, which means to have the property sold on the courthouse steps to pay the debt that's still due to the mortgage company. This is an important creditor's right. The debtor's right that's there which is very important, is the right to have the property sold on the courthouse steps and to not allow the mortgage company to come in and seize and just take and keep the property, because what if there's only \$25,000 owed on the mortgage and he has already paid off \$125,000, and the property has gone up in value – it may be worth \$300,000. The borrower wasn't able to make a payment and he is in default, but he doesn't want the whole property taken for his debt – he wants it sold on the courthouse steps, so that someone else may come along and bid at the auction to pay off that mortgage company's \$25,000 that's in default so that any excess money bid is paid to the debtor. And that would be one of the rights you'd want to write down if you kept a record of debtor's rights.

In America we also have other debtor's rights. We have the right of the debtor to not have his automobile or property seized by a breach of the peace. It can only be seized in a peaceable manner. That is why when banks give loans on automobiles they often will

keep a key so when they hire a company to foreclose or seize the property when there is a default the company can take the automobile when someone goes shopping or when they aren't around, because they don't want to come and have a fight with the person because then they are doing something illegal if they must fight or use force. Debtor's rights vary from state to state. Some states give debtors more rights than others. We have Southern states that enlarged debtor's rights right after the Civil War to protect themselves from the Northern army of occupation because of the fact that no one had any money right after the civil war. We have states that do not allow debtor's homesteads to be taken by creditors. Someone's home that he resides in as head of the household cannot be taken to satisfy a debt in my home state of Florida and several other states in America. The federal government says that no more than 1/4 of a person's wages may be seized to apply to a debt. So let's say someone owes a judgment of \$50,000 because he didn't pay his credit card and he owes the bank \$50,000, but he has a written judgment against him. You send the sheriff out to execute on that judgment or to execute on a 3rd type of execution we have – a Writ of Garnishment. Garnishment is when you seize goods not from the individual debtor, but property of a debtor in the hands of 3rd party - the 3rd party being the bank. So you want to garnish the bank or you want to garnish the employer who owes money to the debtor – his or her weekly salary or paycheck. Wages may be garnished for the payment of a Judgment, but the federal government has a law which says you can only garnish up to 25% of a person's wages. So 75% is protected and only 25% of every paycheck can be garnished.

I don't know if we talked about another debtor's right – the protection against credit bureaus giving improper reports, but every person who might have a false report in the credit bureau records about not paying his debts has the right to place, within 15 days of discovering that there's false information, his written explanation of the situation with the credit bureau. So if the credit bureau reports that a person does not make payments on time or has a bad credit rating that may prejudice him in getting a loan or getting credit somewhere to buy things, every individual has the right to place his own version of events and explanation as to why he didn't make a payment or a payment on time in the credit bureau records.

This is all I'm going to say about the Credit System in America. – it is important in the US; it is a major business - and you know that The Business of America is Business. I just wanted to open the door a little bit to how our legal system allows credit to exist and expand.