



---

Fall 9-1-2004

## Racial Dimensions of Credit and Bankruptcy

David A. Skeel, Jr.

Follow this and additional works at: <https://scholarlycommons.law.wlu.edu/wlulr>



Part of the [Banking and Finance Law Commons](#), [Bankruptcy Law Commons](#), and the [Civil Rights and Discrimination Commons](#)

---

### Recommended Citation

David A. Skeel, Jr., *Racial Dimensions of Credit and Bankruptcy*, 61 Wash. & Lee L. Rev. 1695 (2004).

Available at: <https://scholarlycommons.law.wlu.edu/wlulr/vol61/iss4/8>

This Article is brought to you for free and open access by the Washington and Lee Law Review at Washington and Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Washington and Lee Law Review by an authorized editor of Washington and Lee University School of Law Scholarly Commons. For more information, please contact [christensena@wlu.edu](mailto:christensena@wlu.edu).

# Racial Dimensions of Credit and Bankruptcy

David A. Skeel, Jr.\*

## Table of Contents

I. Introduction .....	1695
II. The Mystery of the Missing Bankruptcy Practice: Credit and Race in the Middle Decades .....	1698
A. A Brief Overview of a Prominent Black Philadelphia Law Firm .....	1699
B. Explaining the Absence of Bankruptcy .....	1700
III. Credit Cards, Bankruptcy, and Consumer Protection in the 1970s .....	1706
IV. The New Face of Credit Market Discrimination.....	1712
A. The Evidence That Discrimination Has Not Disappeared .....	1713
B. Why the Continuing Discrimination? .....	1715
C. Credit Cards and the Advent of Impersonal Credit.....	1717
D. Racial Dimensions of Bankruptcy .....	1719
V. Conclusions and Implications.....	1720

## I. Introduction

"Again," W.E.B. DuBois wrote over a century ago at the end of his classic sociological study *The Philadelphia Negro*, "the white people of the city must remember that much of the sorrow and bitterness that surrounds the life of the American Negro comes from the unconscious prejudice and half-conscious actions of men and women who do not intend to wound or annoy."<sup>1</sup>

---

\* Visiting Professor of Law, Georgetown University Law Center, and S. Samuel Arsht Professor of Law, University of Pennsylvania Law School. I am grateful to Seth Chertok, Bill Draper, and Merle Slyhoff for research and library help; to Dorothy Brown, Mitu Gulati, Ken Mack, and David Wilkins for comments on earlier drafts; and to the University of Pennsylvania Law School for generous summer funding.

A "generous granting of opportunity to them," a "seconding of their efforts, and a desire to reward honest success—together with proper striving on their part—will go far," he concluded, "even in our day toward making all men, both white and black, realize what the great founder of the city meant when he named it the City of Brotherly Love."<sup>2</sup>

In the century since its publication, DuBois's magisterial analysis, with its hints of both optimism and wistful resignation, has served as a yardstick for measuring racial progress and for understanding the black community in Philadelphia and in the nation as a whole. In his introduction to a recent reprinting of *The Philadelphia Negro*, Elijah Anderson emphasizes both the seminal insights of DuBois's work and several of its limitations.<sup>3</sup> After noting that DuBois's "comments on the twoness of American society, on the separateness and inequality of its white and black worlds, . . . anticipated the work of Gunnar Myrdal, Daniel Patrick Moynihan, and the Kerner Commission Report,"<sup>4</sup> Anderson argues that DuBois put too much confidence in the beneficence of Philadelphia's white business leaders.<sup>5</sup> Anderson also notes that DuBois gave short shrift to the vibrant role of church life in the black community.<sup>6</sup>

This Article focuses on another set of issues that occupies comparatively little of DuBois's attention—namely, credit markets and bankruptcy. Although DuBois briefly explores the role of black lending institutions such as building and loan associations,<sup>7</sup> bankruptcy does not figure in his study at all. There are both simple and more subtle explanations for the omission. The simple explanation is that in 1896, when DuBois conducted his study, there was no federal bankruptcy law on the books in the United States. Not until two years later did Congress finally enact a permanent federal bankruptcy law.<sup>8</sup> More subtly, the very conditions DuBois documented, including the exclusion of blacks from manufacturing jobs in favor of the waves of new

---

1. W.E.B. DUBOIS, *THE PHILADELPHIA NEGRO: A SOCIAL STUDY* 396–97 (Univ. of Pa. Press 1996) (1899).

2. *Id.* at 397.

3. See generally Elijah Anderson, *Introduction to W.E.B. DUBOIS, THE PHILADELPHIA NEGRO: A SOCIAL STUDY* ix–xxxvi (Univ. of Pa. Press 1996) (1899).

4. *Id.* at xxiv.

5. *Id.* at xxxiv–v.

6. See *id.* at xiii (describing DuBois's disdain for religion).

7. DUBOIS, *supra* note 1, at 226.

8. See DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 23–47 (2001) (discussing in detail the advent of the Bankruptcy Act of 1898).

immigrants coming to Philadelphia,<sup>9</sup> were accompanied by sharp limitations on access to credit and business opportunity. Bankruptcy is for debtors—for those who have borrowed money and cannot repay it. Unless there is credit, there will not be bankruptcy.

The goal of this Article is to explore the connections among race, credit markets, and bankruptcy. Because my analysis lacks the extensive empirical grounding of DuBois's study, this Article will have a more speculative and impressionistic tone. But my aim, in the spirit of *The Philadelphia Negro* and the tradition it inaugurated, is to provide as rich a context as possible for understanding the racial dimensions of credit and bankruptcy. This Article draws many of its illustrations from Philadelphia—from the same blocks and neighborhoods that DuBois himself studied—but the Article will also look well beyond the two rivers that bracket the nation's fifth largest city.

Throughout this Article, I use Ray and Sadie Alexander, two of Philadelphia's leading black lawyers in the mid-twentieth century, as a window into black business and financial life. Part II begins with a puzzle: Although prominent black lawyers like the Alexanders developed wide-ranging practices, they do not seem to have handled many bankruptcy cases. Why is this? The most plausible explanations stem from perversities in the credit markets in the 1940s and 1950s. Part II concludes by considering these perversities, as well as the nature of blacks' access to credit in this era. Part III describes the explosion of consumer credit in the 1970s, along with several important legislative reforms that were designed to eliminate discrimination in the credit markets. Part IV turns to the present and offers a progress report on where things currently stand. In the past decade, blacks' access to credit has increased dramatically. However, the shift to mainstream credit from alternative forms of credit has brought its own malignancies, as reflected in recent evidence of discrimination in the automobile and mortgage markets. Indeed—in an irony that is a central theme of this Article—the transition itself has made many of the current problems possible. The most striking legacy of the discrimination of the past is the magnified vulnerability of blacks to more subtle forms of discrimination in the present. After exploring how and why this is so in Part IV, I briefly consider, in Part V, the possibility of credit and bankruptcy reform.

---

9. See DuBois, *supra* note 1, at 26 (detailing how blacks faced fierce competition in the labor market from newly arrived European immigrants).

## II. *The Mystery of the Missing Bankruptcy Practice: Credit and Race in the Middle Decades*

In mid-twentieth century America, black students who aspired to become lawyers faced daunting obstacles. "To most blacks," Geraldine Segal notes in her study of blacks in the law, "it was a goal that seemed to defy social and economic realities."<sup>10</sup> Law schools overtly discriminated in admissions, and even apart from the obstacles to entrance, the cost of a law school education was beyond the reach of all but a few families.<sup>11</sup> In 1910, census records suggest that there were only 798 black lawyers in the entire country, a number that had increased only to 1925 by 1940.<sup>12</sup>

Although the statistics tell a similar story in Philadelphia—in DuBois's study, doctors and lawyers together totaled only 1.5% of the black population, and only twenty-one black lawyers entered the Philadelphia bar between 1909 and 1945<sup>13</sup>—Philadelphia played a prominent role throughout the early history of the black bar and would continue to produce leading black lawyers into the twentieth century.<sup>14</sup> As far back as the antebellum years, the city had an established community of educated blacks.<sup>15</sup> From this community came lawyers such as Aaron Mossell, who became the first black graduate of the University of Pennsylvania in the 1890s and whose brother Nathan achieved similar distinction as the University's first black medical school graduate.<sup>16</sup> Mossell's daughter, Sadie, would form one half of the husband and wife team who became the leading black lawyers in Philadelphia in the middle decades

10. GERALDINE R. SEGAL, *BLACKS IN THE LAW: PHILADELPHIA AND THE NATION* 1 (Univ. of Pa. Press 1983).

11. *See id.* (noting the small number of scholarships available to black law students and the absence of family financial support).

12. *Id.*

13. Charles Lewis Nier III, *Sweet are the Uses of Adversity: The Civil Rights Activism of Sadie Tanner Mossell Alexander*, 8 *TEMPLE POL. & CIV. RTS. L. REV.* 59, 66 (1998). For a discussion of the obstacles faced by would-be black lawyers in the nineteenth and early twentieth centuries, see Dorothy A. Brown, *Faith or Foolishness*, 11 *HARV. BLACKLETTER L.J.* 169, 171–73 (1994) (reviewing J. CLAY SMITH, *THE MAKING OF THE BLACK LAWYER, 1844–1944* (1993)).

14. The early history of black lawyers in Philadelphia is recounted in SEGAL, *supra* note 10, at 27–34 (noting that early records are available only for Aaron Mossell and John Adams Sparks).

15. Kenneth Walker Mack, *A Social History of Everyday Practice: Sadie T.M. Alexander and the Incorporation of Black Women into the American Legal Profession, 1925–1960*, 87 *CORNELL L. REV.* 1405, 1418 (2002).

16. *Id.*

of the twentieth century.<sup>17</sup> Their practice offers a window into the nature of the lives of black lawyers and businessmen during this era.

*A. A Brief Overview of a Prominent Black Philadelphia Law Firm*

Sadie Tanner Mossell Alexander matriculated at the University of Pennsylvania Law School in 1924, shortly after her husband Ray Alexander graduated from Harvard Law School and put out his shingle with another lawyer in Philadelphia.<sup>18</sup> She found the obstacles for a black woman in the law school environment even greater than those faced by black men.<sup>19</sup> In a recent study of her career, legal historian Kenneth Mack notes that the dean of the law school "ordered the women law students to exclude her from their student club. When her grades earned [Sadie] election to the law review after her first year, the dean ordered the editors to deny her membership."<sup>20</sup> But Sadie Alexander persevered and eventually was invited to join the law review after the editor-in-chief lobbied on her behalf the following year.<sup>21</sup>

After graduating in 1927, Sadie joined her husband's law firm, which already had achieved prominence within Philadelphia's black community.<sup>22</sup> The Alexanders would eventually become most famous for their civil rights work that began in the 1920s with a steady stream of challenges to the exclusion of blacks from hotels, restaurants, and movie theaters.<sup>23</sup> The heart of the firm's work, however, was a wide-ranging general legal practice that served middle class blacks in their personal and business affairs.<sup>24</sup> Ray handled most of the cases that involved litigation while Sadie developed an expertise in trusts and estates and in family law.<sup>25</sup>

---

17. See *infra* Part II.A (discussing Sadie and Ray Alexander's Philadelphia law firm). The family also produced a renowned artist. Sadie's maternal uncle, Henry Ossawa Tanner, was a famous ex-patriot painter who studied under Thomas Eakins in Philadelphia and later moved to Paris. Mack, *supra* note 15, at 1418. Tanner's life and work are described in Sharon Kay Skeel, *A Black American in the Paris Salon*, AMERICAN HERITAGE, Feb./Mar. 1991, at 76.

18. Mack, *supra* note 15, at 1406.

19. See *id.* at 1419–20 (describing the rampant prejudice faced by Sadie Alexander as a law student).

20. *Id.*

21. *Id.*

22. See Nier, *supra* note 13, at 66 (describing Sadie Alexander's early work on probate cases at her husband's firm).

23. See *id.* at 72 (discussing the Alexanders' civil rights efforts, culminating in the Pennsylvania Equal Rights Act of 1935).

24. See Mack, *supra* note 15, at 1427 (discussing the firm's various practice areas).

25. See *id.* at 1428 (noting the division of labor between Sadie and Ray).

One practice area that does not seem to have figured prominently in the caseload of the Alexanders or other black lawyers in the middle decades is bankruptcy. In our era, at the outset of the twenty-first century, it would seem a little odd that a moderately large law firm with the Alexanders' caseload did not have at least a small bankruptcy practice, given that bankruptcy is so closely tied both to family law issues and to the realities of small business life. In their era, the absence of any significant bankruptcy practice is, at least at first glance, downright mystifying.

What makes Sadie's apparent absence from the bankruptcy wing of the federal district court so puzzling is that bankruptcy was an outsider practice throughout the middle decades of the twentieth century. Bankruptcy was viewed as an ethnic, urban practice, with the busiest bankruptcy dockets located in New York, Philadelphia, Boston, and other major cities.<sup>26</sup> Particularly in the Northeast, many of the leading members of the bankruptcy bar were Jewish attorneys who had been shut out of the larger big-city law firms that largely or entirely excluded Jews.<sup>27</sup> Bankruptcy lawyers also came from other ethnicities that were not well-represented in the higher reaches of the bar, such as the Italian and Irish communities. In this environment, one might have expected to find Sadie or Ray Alexander regularly representing black clients in bankruptcy cases. But there is little evidence that they, or other black Philadelphia lawyers for that matter, figured prominently in the bankruptcy courts.

### *B. Explaining the Absence of Bankruptcy*

Why did the Alexanders' thriving, wide-ranging general practice seem to omit bankruptcy? The discussion that follows will consider four plausible answers to this question—four interdependent explanations that together may shed some light on both the black bar and American credit markets in the middle decades of the twentieth century. The first and most obvious is that blacks did not have nearly the same access to credit that whites did. In the mid-twentieth century, mainstream banks routinely and often explicitly red-lined black neighborhoods, which cut off a major source of home mortgage

---

26. For a discussion of mid-century bankruptcy practice, which was long bedeviled by allegations that it was dominated by bankruptcy "rings" in urban areas, see SKEEL, *supra* note 8, at 75–77.

27. See *id.* at 75–76, 134 (discussing how many Jewish lawyers carved out a niche in bankruptcy practice after facing discrimination in other practice areas).

financing.<sup>28</sup> Black businessmen were likely to face similar obstacles if they sought a business loan from a mainstream bank.<sup>29</sup> As we will see, discrimination by mainstream banks did not eliminate access to bank credit altogether.<sup>30</sup> But overall, a black homeowner or entrepreneur did not have nearly the same access to conventional credit as white Philadelphians did.

There is a simple but often overlooked connection between the obstacles to obtaining credit and the dearth of bankruptcy cases in the Alexanders' files: Individuals and businesses that do not have access to credit do not file for bankruptcy. In this sense, bankruptcy has always been, oddly enough, a marker of middle class status. The fact that credit is a prerequisite to bankruptcy and that blacks had significantly constrained access to credit may partly explain why we do not find active practice of bankruptcy by black lawyers in the mid-twentieth century.

Blacks' inability to obtain credit cannot be the entire explanation, however, because, as discussed below, black Philadelphians were not cut off from credit altogether. This observation leads directly to the second possible explanation. When conventional sources of credit are foreclosed, whether for legitimate reasons or more pernicious ones, many borrowers turn to alternative forms of credit such as pawnshops and check-cashing outlets.<sup>31</sup> That pawnshops were a significant source of credit in the black community even in the late nineteenth century is evident from a fleeting reference in *The Philadelphia Negro*,<sup>32</sup> and their prominence in underserved communities continued throughout the twentieth century.<sup>33</sup> Check-cashing outlets date back to the 1930s, a decade or two after businesses began to routinely pay their

---

28. See Stephen M. Dane, *Eliminating the Labyrinth: A Proposal to Simplify Federal Mortgage Lending Discrimination Law*, 26 U. MICH. J.L. REFORM 527, 533 (1993) (noting that "economic theorists and appraisers espoused that economic value and loan risk were related to race" in the 1920s and 1930s).

29. See SHELLEY GREEN & PAUL PRYDE, *BLACK ENTREPRENEURSHIP IN AMERICA* 38 (1990) ("[O]nly 10 percent of black business owners indicated [in a 1982 CBO study] commercial banks as sources of equity-base capital for business starts.").

30. See, e.g., *infra* note 38 and accompanying text (discussing how the emergence of black banks and savings and loan associations provided credit to blacks who were denied credit by mainstream banks).

31. See JOHN P. CASKEY, *FRINGE BANKING: CHECK-CASHING OUTLETS, PAWNSHOPS, AND THE POOR* 70 (1994) (noting that, according to pawnshop owners, most of their customers are borrowers who are "excluded from bank or finance company loans," generally because they would not qualify).

32. See DUBOIS, *supra* note 1, at 226 (noting that "loan associations [have] replace[d] the pawn-shops and usurers to some extent").

33. See CASKEY, *supra* note 31, at 45-49 (showing the rise in pawnshop business nationwide, particularly in the southern and mountain states).



employees by personal check.<sup>34</sup> In the middle decades of the twentieth century, pawnshops and check-cashing outlets were an important source of credit for many black borrowers.<sup>35</sup>

Blacks who relied on pawnshops and check-cashing outlets—or more ominously, on loan sharks—had at least some access to credit, but they too were very unlikely to find themselves in bankruptcy even if they failed to repay what they had borrowed. A common characteristic of each of these nonconventional sources of credit is that the lenders rely very little on the formal legal system to assure repayment of the money they lend. This is most graphically illustrated by loan sharks, of course, whose nonlegal debt collection techniques are primitive and often effective. Pawnshop and check-cashing obligations are also designed to be enforced outside of the formal legal system. Pawnshop loans are essentially self-liquidating because the pawnshop simply keeps the collateral—whatever it is that the borrower has hocked—if the borrower fails to repay on time.<sup>36</sup> Check-cashing outlets run a small risk that the check that the borrower wishes to cash will bounce. But the vast majority of employers' checks clear, and the lender knows within a few days whether there is likely to be a problem.<sup>37</sup>

The implications of the two explanations for black lawyers like the Alexanders are straightforward. Both the constraints on blacks' access to conventional credit and their reliance on alternative credit providers would directly reduce the relevance of bankruptcy to blacks. Some blacks, however, did have access to relatively conventional sources of credit in Sadie and Ray Alexander's era, and a third explanation for the apparent absence of bankruptcy cases can be found in the nature of these mainstream credit relationships.

One source of credit was the emergence of black banks and building and loan associations. The Berean Building and Loan Association, the most prominent of the black Philadelphia building and loans, dated back to 1888 and continues to operate even today.<sup>38</sup> For some homeowners and businesses, Berean and other black financial institutions filled the gap left by the reluctance of white banks to lend in the black community.

---

34. See *id.* at 32–33 (describing the origins of check-cashing outlets).

35. See *id.* at 65, 69 (noting the clustering of check-cashing outlets in areas with high concentrations of blacks and the disproportionate number of black customers for pawnshops).

36. See *id.* at 12 ("If the customer does not repay the loan by a specified date, the collateral becomes the property of the broker and the customer's debt is extinguished.")

37. See *id.* at 14 (describing the typical operations of a check-cashing outlet).

38. DuBois notes that, as of the time of his study, the Berean Building and Loan Association had financed the purchase of forty-three homes. DUBOIS, *supra* note 1, at 226.

The Alexanders themselves facilitated the emergence of an additional source of credit. Shortly after they married, the Alexanders bought \$1000 worth of furniture from Wanamaker's department store on credit, thanks to the intercession of a well-placed friend.<sup>39</sup> After the Alexanders established their legal practice and thus their reputation, Sadie began to provide similar favors to friends and acquaintances.<sup>40</sup> "She soon developed a trusting relationship with the managers of Wanamaker's, Gimbel Brothers, and other downtown department stores," according to Kenneth Mack,

[R]eferring African American clients and friends for credit and vouching for their reliability. In keeping with the social conventions of her day, she would entrust to a client or friend a generic note on firm letterhead addressed to the store's management, identifying 'the bearer of this letter' as a trustworthy and creditworthy person.<sup>41</sup>

To be sure, both black financial institutions and the department store credit brokered by prominent blacks such as the Alexanders were subject to important limitations as sources of credit. In Philadelphia and elsewhere, black lending institutions were often thinly capitalized and financially precarious.<sup>42</sup> Additionally, the ability of Ray and Sadie to serve as intermediaries for black borrowers was limited to friends and acquaintances whom they knew well enough to vouch for. Nevertheless, the existence of these lenders suggests that at least some credit was available, and their borrowers are precisely the ones we might expect to find in bankruptcy if their fortunes soured.

Yet even these borrowers were unlikely to come to the Alexanders seeking bankruptcy advice. One reason for this is reputation. Before the advent of credit cards, reputation was important to all credit relations; it is no accident, after all, that "credit" is derived from the same Latin word as "trust" or "entrust."<sup>43</sup> But reputation was especially important to the credit relationships described above. When Sadie vouched for the creditworthiness of a black friend at a Philadelphia department store, both she and the friend

---

39. Mack, *supra* note 15, at 1447.

40. See *id.* at 1448 (describing how the Alexanders used their reputation to obtain loans for other blacks).

41. *Id.*

42. See, e.g., ABRAM L. HARRIS, THE NEGRO AS CAPITALIST: A STUDY OF BANKING AND BUSINESS AMONG AMERICAN NEGROES 142-43 (The Amer. Acad. of Political and Soc. Sci. 1936) (1968) (summarizing the failures of the Brown and Stevens Bank and the Cosmopolitan Bank in Pennsylvania).

43. See AMERICAN HERITAGE DICTIONARY 338 (2d College ed., Houghton Mifflin Co. 1976) (tracing "credit" to "creditum" (to loan) and "credere" (to trust)).

had a tremendous reputational stake in the friend's repayment of the amount borrowed. If the friend failed to repay, Sadie's reputation would be tarnished, and the friend would lose any hope of access to future credit in the Philadelphia community. Because reputation was the glue that held the credit relationship together, borrowers could be expected to go to great lengths to make sure they paid back the money they borrowed (and similarly, to borrow only amounts they were confident they would repay).

Although the heightened role of reputation is not as immediately obvious with the loans made by black financial institutions, reputation played a central role in these transactions as well. Black financial institutions—like their counterparts in minority and ethnic communities today—relied heavily on their understanding of whether the individuals or businesses applying for loans were creditworthy.<sup>44</sup> From the borrower's perspective, maintaining a reputation for creditworthiness was therefore absolutely essential.

The role of reputation is closely related to a quality Glen Loury refers to as "social capital" in his writings on racial discrimination.<sup>45</sup> Before moving on to the final explanation for the absence of a black bankruptcy practice, it is useful to consider how social capital issues fit into the picture.

Loury's analysis of social capital starts from the observation that "individuals are embedded in complex networks of affiliations: they are members of nuclear and extended families; they belong to religious and linguistic groupings; they have ethnic and racial identities; they are attached to particular localities . . . . Opportunity travels along the synapses of these social networks."<sup>46</sup> An individual whose friends or relatives work in a given industry, for instance, may have better access to information about job opportunities in that industry than someone who lacks these contacts.<sup>47</sup>

Loury is primarily concerned with the exclusion of minorities from important social networks, and I will return to this theme when we bring the story to the present.<sup>48</sup> But it is important to recognize that social networks also play a central role *within* the minority community itself. As suggested above,

---

44. For analysis of the dynamics of credit markets within ethnic and racial communities, see generally Lan Cao, *Looking at Communities and Markets*, 74 NOTRE DAME L. REV. 841 (1999); Shubba Ghosh, *The Legal, Economic, and Policy Roles of Immigrant Entrepreneurs in the Immigration Debate*, 5 UCLA ASIAN PAC. AM. L.J. 15, 41–42 (1998).

45. See generally Glenn C. Loury, *Discrimination in the Post-Civil Rights Era: Beyond Market Interactions*, 12 J. ECON. PERSP. 117 (1998) (criticizing traditional economics for not considering the complex social networks which affect a person's access to resources).

46. *Id.* at 119.

47. *Id.*

48. See *infra* Part IV.B (discussing the continuing discrimination in the car-buying industry and how social capital, or the lack thereof, plays a role in this process).

in the black Philadelphia of Sadie and Ray Alexander's era, the few sources of credit that were available to blacks were highly dependant on social relationships, and the principal currency of these relationships was one's reputation within the black community.<sup>49</sup> Because access to credit was so dependent on reputation, borrowers had an extremely strong incentive to repay the amounts that they borrowed. Of course, this does not mean that no black borrower would ever end up in bankruptcy; even in close-knit communities reputation is not a perfect predictor of creditworthiness, and at least a few otherwise creditworthy borrowers may fail for reasons that could not have been predicted in advance. On balance, however, one would expect to see comparatively fewer bankruptcies in a community whose credit relationships are strongly dependent on reputation.

The final explanation for the relative absence of bankruptcy cases from the Alexanders' practice underscores an enduring dilemma for black lawyers who were trying to establish an economically stable legal practice. When black business owners faced major legal issues such as financial distress and the prospect of bankruptcy in the middle decades of the twentieth century, they frequently took their cases to white law firms.<sup>50</sup> "[B]lack lawyers always complained," as one legal historian puts it, "that the more important the business matter, the more likely the black business was to take it to white lawyers."<sup>51</sup> From the business owner's perspective, this decision made perfect sense. In an era when nearly every judge was white and where the vast majority of the lawyers who appeared before them were white, hiring a white law firm to handle a crucial issue was the safest strategy. Although a few black lawyers were so prominent that they might plausibly attract a major business case, the vast majority of this work went to white lawyers.<sup>52</sup> The fact that black clients took their most significant cases to white lawyers meant that, even with respect to the black borrowers who did have access to credit and

---

49. See *supra* notes 43–44 and accompanying text (explaining that "reputation was the glue that held the credit relationship together").

50. E-mail from Kenneth Mack, Assistant Professor of Law, Harvard Law School, to David A. Skeel, Jr., Professor of Law, University of Pennsylvania Law School (Mar. 13, 2004) (on file with the Washington and Lee Law Review).

51. *Id.*

52. As DuBois noted in a brief discussion of black Philadelphia lawyers, "a lawyer must have co-operation from fellow lawyers and respect and influence in court; thus prejudice or discrimination of any kind is especially felt in this profession." DUBOIS, *supra* note 1, at 115. Interestingly, DuBois himself counseled blacks to use white attorneys in major civil rights cases in order to offset the hostility to black lawyers and civil rights suits. See Brown, *supra* note 13, at 178–79 (noting that DuBois "criticized black lawyers who refused to turn their cases over to white lawyers at the appellate level").

who subsequently faced financial distress, there was a very good chance that their file would never make its way to a black lawyer's in-box.

To underscore what is no doubt already obvious, the four explanations discussed above have somewhat different implications. Inability to borrow and use of alternative sources of credit both raise issues of access to conventional credit. Reputation-intensive borrowing is related, but it introduces additional issues such as the role of social networks within the black community. The tendency for black clients to take their major cases to white lawyers is indirectly related to the issue of access to credit because the same social networks that tended to constrain blacks' access to credit were also reflected in the judiciary and the mainstream bar. It is also quite plausible, however, that black lawyers would not have gotten the best cases even if blacks had the same access to credit as whites. Credit markets and bankruptcy would change a great deal in the second half of the twentieth century, but each of the concerns we have just explored continues to leave its trace, as we will see.

### *III. Credit Cards, Bankruptcy, and Consumer Protection in the 1970s*

The credit markets that Sadie and Ray knew looked radically different from the world we see at the outset of the twenty-first century. Many of the most dramatic changes came during a few short years in the mid- and late-1970s. During this period, Congress enacted legislation that explicitly outlawed discrimination by lenders,<sup>53</sup> and credit markets were transformed both by a Supreme Court decision and by a sweeping revision of the bankruptcy laws.<sup>54</sup> This Part will explore the relationships among credit, race, and bankruptcy today. First, however, we should briefly consider certain developments in the 1970s that made the current environment possible.

The Alexanders themselves left their fingerprints on the developments that led to the civil rights revolution of the 1950s and 1960s. The Equal Rights Law,<sup>55</sup> an important early civil rights bill that outlawed discrimination in public accommodations in Pennsylvania, was signed in the Alexanders' law

---

53. See *infra* notes 59–67 and accompanying text (discussing the Equal Credit Opportunity Act of 1974 and the Community Reinvestment Act of 1977).

54. See *infra* notes 72–76 and accompanying text (discussing the Supreme Court's opinion in *Marquette National Bank v. First of Omaha Service Corp.*).

55. See, e.g., Nier, *supra* note 13, at 73 & n.92 (quoting the Equal Rights Law in its entirety and describing it as "the greatest single step taken by the Keystone State in seventy years").

offices in 1935.<sup>56</sup> A decade later, Sadie served as one of fifteen members of the Committee on Civil Rights under President Harry Truman.<sup>57</sup> The Committee's 1947 report, "To Secure These Rights," has been described as having "established the basic blueprint for the civil rights revolution that followed in the [next] twenty years."<sup>58</sup>

Although the civil rights campaigns climaxed in the 1960s and the landmark legislation of that decade was foundational to everything that followed, several of the most important efforts to counteract discrimination in the credit markets came in the following decade. In 1974, Congress enacted the Equal Credit Opportunity Act (ECOA).<sup>59</sup> The ECOA originally prohibited banks and other financial institutions from taking sex or marital status into account in their lending decisions; two years later, lawmakers amended the legislation to prohibit lenders from asking questions related to race.<sup>60</sup>

A second major legislative change was the Community Reinvestment Act of 1977 (CRA).<sup>61</sup> Rather than a negative prohibition on discrimination, the CRA is framed as an affirmative requirement that banks demonstrate their commitment to lending to disadvantaged neighborhoods.<sup>62</sup> The precise content of the CRA's obligations is notoriously unclear. The Act simply instructs banks to meet "the credit needs of [their] entire communit[ies], including low- and moderate-income neighborhoods, consistent with . . . safe and sound operation,"<sup>63</sup> without giving any guidance as to what it means to satisfy a community's credit needs. In practice, regulators have invoked the CRA when banks seek approval of a major transaction such as a merger.<sup>64</sup> Based on the language quoted above, regulators can refuse to approve a proposed merger unless the banks in question agree to increase their lending to underserved

---

56. *Id.* at 72.

57. *Id.* at 76.

58. *Id.* at 77.

59. For the current version of the ECOA, see 15 U.S.C. § 1691 (2000).

60. For a discussion of the enactment of, and post-enactment experience with, the ECOA, see generally Dane, *supra* note 28, at 546–49; Willy E. Rice, *Race, Gender, "Redlining," and the Discriminatory Access to Loans, Credit, and Insurance: An Historical and Empirical Analysis of Consumers Who Sued Lenders and Insurers in Federal and State Courts, 1950–1995*, 33 SAN DIEGO L. REV. 583, 637–46 (1996).

61. To read the CRA in its current version, see 12 U.S.C. §§ 2901–2908 (2000).

62. See 12 U.S.C. § 2903(a)(1) (2000) (noting that federal regulatory agencies shall "assess the institution's record of meeting the credit needs of its entire community").

63. *Id.*

64. See Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 300 (1993) (describing the methods taken by the government to assure compliance with the CRA).

communities.<sup>65</sup> In effect, the CRA serves as a bargaining chip that regulators use to craft community-by-community deals on acceptable lending practices.<sup>66</sup> Nothing in the CRA links regulators' authority explicitly to race or minority status, but a disproportionate number of the communities in question are black or Latino, and the Act clearly was designed to counteract the effects of historical lending discrimination.<sup>67</sup>

In the same decade that both of these antidiscrimination measures were enacted, America's conventional credit markets also were undergoing dramatic changes. For the first time, thanks to credit cards, millions of Americans were able to borrow significant amounts of money without ever meeting their lender face-to-face: no anxious meeting with the local bank, just an application to fill out and stick in the mail. Shortly after the credit card revolution came the advent of subprime lending—mortgage-based loans to consumers whose finances would previously have been viewed as too precarious to justify a loan.<sup>68</sup> Why the sudden surge in credit cards and subprime lending? A big part of the explanation is technological. New computer tracking software, for instance, enabled credit card companies to assess a borrower's credit risk more quickly and accurately than ever before.<sup>69</sup> This technology not only helped credit card banks decide whether to approve the borrower's credit card application in the first instance, but it also helped them to make instant

---

65. See *id.* (explaining the dangers posed by an adverse CRA ruling to merging or expanding banks).

66. See *id.* at 333–39 (examining how community interest groups, with the assent of regulators, use the CRA as a means of extracting concessions from banks).

67. The CRA provoked significant controversy after its enactment. For criticism of the Act, see generally *id.* (emphasizing the costs of the Act's obligations and criticizing the "localism" of the CRA); Lawrence J. White, *The Community Reinvestment Act: Good Intentions Headed in the Wrong Direction*, 20 FORDHAM L.J. 281 (1993) (arguing that banks cannot afford to provide CRA services in the long run if they are making only ordinary returns on their other business). For a more sympathetic view, see generally Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349 (1993) (proposing the use of safe harbors as a way of alleviating Macey and Miller's concerns).

For proposed alternatives to the CRA, see generally Michael Klausner, *Market Failure and Community Investment: A Market-Oriented Alternative to the Community Reinvestment Act*, 143 U. PA. L. REV. 1561 (1995) (proposing market-based reforms, such as tradable loan obligations, as a substitute for the CRA).

68. See generally TERESA SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 23 (2000) (describing the advent of subprime lending).

69. See ROBERT D. MANNING, *CREDIT CARD NATION: THE CONSEQUENCES OF AMERICA'S ADDICTION TO CREDIT 2* (2000) (noting that "the ongoing technological advances of 'rational' computer processing systems and the economics of scale they provide imply that the credit card industry has expanded into new markets of more economically marginal members").

decisions regarding whether to approve the credit when the borrower presented her card to a merchant.

At least as significant as the technology were two critically important legal developments that occurred in 1978: the Supreme Court's decision in *Marquette National Bank v. First of Omaha Service Corp.*<sup>70</sup> and President Carter's signing of the 1978 Bankruptcy Code.<sup>71</sup> In *Marquette*, the Supreme Court held that the relevant rules for interest rates on consumer debt would be determined by the law of the bank's state of incorporation, rather than by the state where the credit card customer lived or used the card.<sup>72</sup> As innocuous as the Court's conclusion may sound, it had profound implications for the credit card industry.<sup>73</sup> Credit card banks could simply pick the state with the weakest interest rate regulations and set up shop there, with the assurance that any interest rate permitted by the bank's home state would apply to transactions throughout the country. Banks immediately flocked to South Dakota, which permitted banks to charge up to 24% interest, and within a few years to Delaware, which also entered the competition to attract credit card lenders.<sup>74</sup> In effect, *Marquette* deregulated interest rates. Freed from the shackles of restrictive state usury regulation, credit card companies could charge extremely high interest rates and give credit cards to almost everyone.<sup>75</sup> Even if many of these new borrowers defaulted, the banks' high profits would more than offset the losses.<sup>76</sup>

The enactment of the 1978 Bankruptcy Code had a similarly profound effect. The 1978 Code is best known for making the bankruptcy process much more hospitable for debtors, an effect that was reflected both in specific provisions and in the terminology of the new Code.<sup>77</sup> But creditors were not

---

70. *Marquette Nat. Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978).

71. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

72. See *Marquette*, 439 U.S. at 301 (affirming a Minnesota Supreme Court decision that permitted out-of-state banks to charge higher credit card rates than the state statutory maximum).

73. Congress later enshrined the holding of *Marquette* in federal banking law by incorporating it into the Financial Institutions Reform, Recovery, and Enforcement Act, 12 U.S.C. § 1831(d) (2000).

74. See, e.g., MANNING, *supra* note 69, at 94 (discussing the effects of *Marquette*).

75. See *id.* at 88-89 (describing Citibank's efforts to escape usury laws by extending credit to lower-income consumers).

76. For evidence that lending has moved down the economic ladder to encompass low-income households, see David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 332-46 (1999).

77. Under the Code, consumer debtors are, among other things, permitted to exempt more property from creditors than in the past, and in Chapter 13, bankruptcy's automatic stay prevents creditors from collecting debts not just from the debtor herself, but also from any



simply abandoned by the drafters of the Code. Not only does the Code provide a variety of basic creditor safeguards, but a few politically influential creditors garnered special treatment for themselves.<sup>78</sup> None were more successful than home mortgage lenders.<sup>79</sup> The mortgage lending industry persuaded Congress to include provisions that give mortgagees almost complete protection, provisions that have figured prominently in the rise of subprime lending.<sup>80</sup>

Bankruptcy is designed to permit consumer debtors either to restructure their obligations in Chapter 13 or to erase them altogether in Chapter 7. With home mortgages, however, a small cluster of provisions in the 1978 Code prohibits consumer debtors from interfering with the mortgage in any way.<sup>81</sup> Unlike debts secured by other interests in property, which can be reduced to the value of the property if the property is worth less than the amount owed, the debtor's home mortgage must be paid in full if the debtor wishes to keep her house after she files for bankruptcy.<sup>82</sup> Mortgage lenders insisted that the new provisions were more than simply a valentine from Congress, of course; the lenders had a very plausible argument for why the protection was necessary.<sup>83</sup> If debtors could scale their mortgage obligations down to the current value of the house, lenders argued, the mortgage lending industry

guarantors or other "co-debtors," during the bankruptcy case. See 11 U.S.C. § 522 (2000) (listing property exempt from creditors); *id.* § 1301 (providing a stay of action of creditors against co-debtors). The most striking terminology change is the decision to refer to consumers who filed for bankruptcy as "debtors" rather than as "bankrupts," which the drafters of the Code viewed as pejorative. SKEEL, *supra* note 8, at 98, 192.

78. See, e.g., 11 U.S.C. § 1110 (2000) (providing for special protection of lessors and vendors of aircraft equipment and vessels).

79. See WILLIAM D. WARREN & DANIEL J. BUSSEL, *BANKRUPTCY* 570 (6th ed. 2002) (noting the outcry of mortgage industry lobbyists over the proposed 1978 Bankruptcy Code).

80. *Id.*

81. See 11 U.S.C. § 1322(b)(2) (2000) (prohibiting modification of "a claim secured only by a security interest in real property that is the debtor's principal residence"). In Chapter 7, the debtor can redeem personal property by paying the creditor the current value of the property, but this option is not available for the debtor's house. *Id.* § 722.

82. If the debtor owes \$10,000 on a car loan, for instance, but her car is only worth \$7000, the debtor can "redeem" the car by paying \$7000 in cash. *Id.* § 722. The remaining \$3000 is treated as an unsecured claim. *Id.* § 506. See also *id.* § 1322(b)(2) (providing for "cramdown" of undersecured liens other than home mortgages in Chapter 13). As a result, the debtor can keep her car without being forced to pay more than the car is worth. Although a few courts interpreted § 1322(b)(2) to allow a similar "cramdown" of home mortgages, the Supreme Court foreclosed this interpretation in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993).

83. See WARREN & BUSSEL, *supra* note 79, at 570 (describing the mortgage lenders' rationale for opposing the original proposal).

would have to pass on these losses to the next round of homebuyers.<sup>84</sup> This would mean higher interest rates and, for some would-be homebuyers, no financing at all. Protection of home mortgages was therefore in everyone's best interest because it would ensure a steady stream of affordable financing to ordinary Americans who wished to buy their own homes.<sup>85</sup>

Whatever the merits of these arguments, bankruptcy's mortgage protection scheme has, quite accidentally, been a boon for the subprime lending industry.<sup>86</sup> When a subprime lender tells a homeowner that she can solve her financial problems by consolidating her debts into a single loan secured by a second mortgage on her house, the lender knows that the mortgage, unlike the debts it replaces, cannot be restructured in bankruptcy if the homeowner later defaults.<sup>87</sup> If the homeowner does not want to give up her house, she will have to pay the mortgage in full. Together with deregulated interest rates, this mortgage protection sets the stage for a dramatic expansion of subprime lending.<sup>88</sup> If subprime lenders set the interest rate high enough, they could lend profitably to almost anyone who owned a house, even those in the most financially precarious position. The interest rate compensates for the high risk, and the mortgage protection provisions make it hard for overextended homeowners to use bankruptcy to scale down the debt.

The events set in motion in the 1970s utterly transformed American credit markets. More credit is available than ever before, and much of it takes a very different form than the credit arrangements of the past.<sup>89</sup> During the same decade, Congress took major steps to try to end discrimination in credit markets.<sup>90</sup> Did the discrimination of Sadie and Ray Alexanders' era

---

84. *Id.*

85. *Id.*

86. See Moss & Johnson, *supra* note 76, at 337–43 (explaining how lenders have greatly expanded business in home equity lines of credit).

87. This restriction is a very important consequence of debt consolidation loans. Although they may reduce the interest rate a debtor is required to pay, loans secured by a mortgage on the debtor's house ordinarily cannot be eliminated in bankruptcy. By contrast, most credit card debts can be discharged. For a wrenching story on the potential consequences of the nondischargeability of home equity debt, see Michael Moss, *Erase Debt Now. (Lose Your House Later.)*, N.Y. TIMES, Oct. 10, 2004, at sec. 3, p. 1.

88. See Moss & Johnson, *supra* note 76, at 334–43 (showing statistics confirming the expansion in low-income debt).

89. See *supra* notes 30–53 and accompanying text (explaining that blacks had limited access to credit prior to the 1970s); *supra* notes 54–77 and accompanying text (discussing how the advent of credit cards and subprime lending, along with statutes that prohibited credit discrimination, led to increased credit access for blacks).

90. See *supra* notes 59–67 and accompanying text (discussing the ECOA and CRA).

disappear? How have the changes in the credit markets played out for blacks and other minorities? It is to these questions that we now turn.

#### IV. *The New Face of Credit Market Discrimination*

If we shift our perspective forward from the 1970s to the present, it is immediately obvious that remarkable strides have been made. Discriminatory practices, such as the red-lining of minority neighborhoods by banks, are much less common than in the past.<sup>91</sup> Many blacks who simply had no access to conventional credit in the past are now able to obtain mortgage lending, credit cards, and car loans. As credit card use has skyrocketed and the subprime lending market has emerged, blacks and other minorities have figured prominently in the expansion.

However, the effects of discrimination have not disappeared. Although black borrowers have access to a much wider range of credit than ever before, the nature of this access often seems to differ from that of whites in troubling respects. This Part begins by considering evidence suggesting that blacks still often borrow on different terms than whites and then discusses some of the reasons for these differences.<sup>92</sup> A key theme of the discussion is that the very developments that this Article has chronicled—in particular, the shift to conventional credit from unconventional and reputation-based credit—contributed to the differential treatment that we now see.<sup>93</sup> The transition from one set of credit options to another has magnified the risk of the subtle forms of discrimination that we currently observe. This transition does not mean that black borrowers are worse off than they were in the Alexanders' era or in the decades that followed, but the transition does suggest that serious problems remain and that the old remedies may not be adequate to address them. In addition to considering the pernicious side of the new landscape for individual black borrowers, I also explore two related issues: the relationship between the shift in credit markets and black borrowers' access to bankruptcy, and the effect that the transition has had on black lending institutions.<sup>94</sup>

---

91. *But see* Dane, *supra* note 28, at 537 (noting that "blatant" discrimination began to disappear in the 1970s but arguing that "subtle" discrimination remains).

92. *See infra* Part IV.A (discussing a study conducted by the Federal Reserve Bank of Boston that shows lending discrimination still exists today); *see also* Part IV.C (positing that although there is a lack of empirical evidence demonstrating credit card discrimination, such discrimination likely still exists).

93. *See infra* Part IV (explaining how the transition from nonconventional credit to more conventional forms has made blacks susceptible to unscrupulous lending practices).

94. *See infra* Part IV.D (explaining how blacks who use credit cards and subprime lending

A. *The Evidence That Discrimination Has Not Disappeared*

The most famous evidence that credit market discrimination still exists is a controversial mortgage lending study by the Federal Reserve Bank of Boston from 1992.<sup>95</sup> The Bank put together a dataset that included every loan application by a minority in the Boston metropolitan area in 1990, together with a random sample of applications by whites in the same year.<sup>96</sup> The Bank then used this data to compare the loan denial rates of minorities and whites.<sup>97</sup> Based on the raw numbers alone—without correcting for factors such as the loan applicants' income and credit history—the study found that 28% of the minority applicants were rejected, as compared to only 10% of the whites.<sup>98</sup> Even after taking differences in the applicants' qualifications into account, the denial rate for minorities was still eight percentage points higher (roughly 18% for minorities, 10% for whites).<sup>99</sup> Although the study triggered a fierce debate—the *New York Times* noted that "otherwise mild-mannered academic experts have gotten into mudslinging matches over the research's implications"<sup>100</sup>—the underlying conclusions are compelling. At the least, as economist Helen Ladd points out, "the Boston Fed study provides persuasive evidence that lenders in the Boston area discriminated against minorities in 1990, even in the presence of clear laws that make racial discrimination unlawful."<sup>101</sup>

Although the Boston Federal Reserve Bank study is the most careful recent analysis of racial patterns in mortgage lending, other studies tell a similar tale. For example, based on a survey of almost 200,000 New York City loan applications, the office of Senator Charles Schumer concluded both that racial discrimination continues to infect bank lending and that "many black homeowners who are more than qualified to receive low interest loans from conventional lenders don't even apply."<sup>102</sup> In an interview publicizing

---

may not have the same access to bankruptcy proceedings as do whites, mainly because of the type of credit involved).

95. See Helen F. Ladd, *Evidence on Discrimination in Mortgage Lending*, 12 J. ECON. PERSP. 41, 50 (1998) (describing the nature of the Boston Federal Reserve study). The study examined 700 minority loan applications and 2300 nonminority loan applications. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. Peter Passell, *Race, Mortgages and Statistics; The Unending Debate over a Study of Lending Bias*, N.Y. TIMES, May 10, 1996, at D1.

101. Ladd, *supra* note 95, at 53.

102. Raymond Hernandez, *High-Cost Lenders Dominate in Black Areas, Study Finds*, N.Y.

the findings, Senator Schumer speculated that "[a]fter years of mistrust, years of discrimination, many black homeowners simply do not want to risk the humiliation of being turned down for a loan by the bank."<sup>103</sup>

If we shift from the initial loan to refinancing—the context in which subprime lending has mushroomed—the evidence is similarly distressing. When whites refinance their mortgages in order to take advantage of lower interest rates or to finance home improvements, nine out of ten refinance with prime lenders at competitive rates, according to a study of Chicago borrowers.<sup>104</sup> By contrast, 50% of black borrowers refinance with subprime lenders at much higher rates, even in middle class neighborhoods.<sup>105</sup>

When blacks and whites purchase cars rather than houses, we find a very similar pattern. In the early 1990s, law professor Ian Ayres sent "testers" to car dealerships throughout the Chicago area.<sup>106</sup> Although the testers wore similar clothes (for the men this meant "polo or button-down shirts, slacks, and loafers," and for the women "straight skirts, blouses, minimal makeup, and flats") and followed the same "script," black testers were quoted significantly higher prices than their white counterparts.<sup>107</sup> Inspired by Ayres' work, investigators subsequently determined that GM dealerships offered inferior credit terms to black customers, charging blacks appreciably higher interest rates than whites with the same credit history and income profile. Thus, with the two most important credit transactions in most Americans' lives, blacks still face a stubborn residue of the differential treatment that the civil rights laws of the 1960s and 1970s were intended to eliminate. Although overt discrimination is less common, more subtle forms of discrimination have endured.

---

TIMES, Apr. 3, 2002, at B6.

103. *Id.*

104. See Bill Dedman, *Study Discerns Disadvantage for Blacks in Home Mortgages*, N.Y. TIMES, Nov. 14, 1999, § 1, at 18 (examining the subprime loan rates extended to white homeowners).

105. See *id.* (examining the high rates of subprime loans to black homeowners).

106. Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 818–19 (1991) [hereinafter Ayres, *Fair Driving*]. Ayres also incorporated these findings into the first part of a recent book. See generally IAN AYRES, PERVASIVE PREJUDICE? UNCONVENTIONAL EVIDENCE OF RACE AND GENDER DISCRIMINATION 19–44 (2001).

107. Ayres, *Fair Driving*, *supra* note 106, at 825.

### *B. Why the Continuing Discrimination?*

Several years ago, as my 1985 Toyota Corolla finally began to sputter, I decided the time had come for a new car. I had no idea how to go about buying a car. The first thing I did was to ask my father-in-law for suggestions. He had recently bought a car himself—this, in fact, was one of the reasons I decided to get into the car market myself—and he is both more sophisticated and more careful about purchases than I am. He told me that the price the dealer itself pays for cars is readily available on the Internet and that sales people can be expected to accept an offer that gives them a couple hundred dollars above this amount. Working with this knowledge—and with otherworldly patience—my father-in-law had hammered out a deal for his own new car over the course of six or eight visits to a local dealership.

After processing this information and considering my options, I decided on my strategy. I drove to the dealership and found the salesman who had worked with my father-in-law. I told the salesman that if he gave me the same terms as he gave my father-in-law, I would sign the papers that night. Somewhat bemused by my technique, the salesman agreed, but there turned out to be one small hitch. I wanted a white Camry, and the only white Camry on the lot had special wire-rim hubcaps. The hubcaps would cost an extra \$200. In the end, the little hitch—the hubcaps could not simply be switched with ordinary ones, of course—meant that I wound up with a black Camry rather than a white one and had to return to complete the sale later in the week.

On the evening we finalized the sale, the salesman pointed me down the hall, past a television room full of toys and the smell of burned coffee, to the manager's office. The papers were on the manager's desk when I arrived, and he began to explain the importance of having an adequate warranty on the car. He always gets a significant warranty when he buys a car, he said, because he wants to make sure his family is protected if the unthinkable ever happened. The dealership offered several plans, with different coverage and different durations. The plans were attractive and somewhat confusing, but I knew from my father-in-law's tutorial that, whatever the question was, my answer should be no. Warranties and other extras, he told me, even more than the cars themselves, are where many dealerships make their profit. After my third "I don't think so," the manager finally relented, and we signed the papers.

As I think back through this experience, I am reminded of Loury's notion of social capital.<sup>108</sup> When I wanted to buy a car, I was surrounded by people

---

108. See *supra* notes 45–49 and accompanying text (explaining how Loury's idea of social capital fits into the picture of blacks' access to credit).

who understood how the sales process worked and could steer me away from expensive mistakes. A car buyer whose family and friends—whose community—did not have substantial experience with conventional credit, by contrast, would be far more likely to spend more than she needed to. One can easily imagine such a person buying unnecessary extras or paying too high an interest rate for their car financing.<sup>109</sup> Informational differences of this sort—due at least in part to the lingering legacy of the overt discrimination of the past—may contribute to the high costs blacks pay when they buy cars or refinance their houses.

Other factors almost certainly contribute as well. One of the most important insights of Critical Race Theory is its identification of the pervasiveness of unconscious discrimination.<sup>110</sup> Many of us engage in discrimination that we are not fully aware of. Recognition of this fact has had a powerful impact on Equal Protection scholarship,<sup>111</sup> and it may help to explain the discrepancies between the terms of credit offered to blacks and the terms offered to whites. For example, in Ayres's study, car dealers quoted higher prices to blacks from the outset, which suggests that there was more going on than simply informational differences between white and black customers.<sup>112</sup>

Economists have developed still another explanation—one that characterizes the differences as conscious but not necessarily due to malignant motives. Usually described as "statistical discrimination," this perspective suggests that race is often used as a proxy for other traits, such as diligence or technical proficiency, that are difficult to observe.<sup>113</sup> For instance, a taxi driver may refuse to stop for a young black man for fear that the man will be headed for a dangerous neighborhood.<sup>114</sup> In the credit context, lenders may believe

109. In the course of a lawsuit for lending discrimination by Citibank in the mortgage context, a Citibank employee admitted that she routinely tacked on extra fees if the applicant was a minority. ELIZABETH WARREN & AMELIA TYAGI WARREN, *THE TWO INCOME TRAP* 160 (2003) (quoting from the employee's affidavit).

110. For the classic article on unconscious discrimination, see Charles R. Lawrence III, *The Id, the Ego, and Equal Protection: Reckoning with Unconscious Racism*, 39 STAN. L. REV. 317 (1987).

111. See, e.g., Rachel F. Moran, *The Elusive Nature of Discrimination*, 55 STAN. L. REV. 2365, 2378 (2003) (noting that critical race theorists "have shaped discussions of the role of discriminatory intent in equal protection law, and they have shifted attention from individual animus to institutional racism").

112. Ayres, *Fair Driving*, *supra* note 106, at 831.

113. For a discussion of the self-fulfilling quality of statistical discrimination, see Loury, *supra* note 45, at 123–24.

114. The taxi driver example is a staple in the economic literature. See, e.g., *id.* at 123 (employing the taxi driver hypothetical to demonstrate that "the empirically valid statistical

that blacks are more likely to be poor credit risks than similarly situated whites; car salesmen may believe that blacks will be willing to pay higher prices for cars than whites. Complicating this pattern of differential treatment is the fact that statistical discrimination is not limited to whites. Often it is black salesmen or bank officials who discriminate against other blacks, a pattern that has become known as "affinity fraud."<sup>115</sup>

These types of discrimination are closely intertwined, of course. For example, when lenders or employers use race as a proxy for other qualities, "their actuarial guesses may depend on incomplete information tainted by patterns of segregation."<sup>116</sup> In effect, racial considerations enter into the credit rationing that may occur when lenders have incomplete information about the creditworthiness of potential borrowers.<sup>117</sup> Similarly, it is often difficult to distinguish between racial hostility, on the one hand, and statistical discrimination, on the other. Furthermore, differences in social capital may affect the price that a person will willingly agree to pay for a car or credit. But the underlying point is the same: In a variety of contexts, the terms of blacks' access to credit look appreciably different from the terms offered to whites.<sup>118</sup>

### C. Credit Cards and the Advent of Impersonal Credit

What about the other great lending development of the past generation: credit cards? Here, there do not yet seem to be any studies showing patterns of discrimination. It is possible, in fact, that credit card lending is free from the racial distinctions that taint the automobile and mortgage markets. Here is the thinking: Unlike home and car lending, the credit card application process

---

generalizations lying at the heart of . . . discrimination can be self-fulfilling prophecies," and thus, "statistical racial discrimination should be treated with legal suspicion").

115. For an interesting and troubling analysis of affinity fraud in the securities context, see Lisa Fairfax, *The Thin Line Between Love and Hate: Why Investment Fraud Constitutes a Hate Crime*, 36 U.C. DAVIS L. REV. 1073 (2003).

116. Moran, *supra* note 111, at 2387.

117. For a discussion of credit rationing in subprime lending, and an argument that it largely has been eliminated in legitimate subprime lending markets but not in markets that historically were subject to rationing and discrimination, see Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1272-73, 1278-79 (2002) (drawing on the classic Stiglitz-Weiss credit rationing model set forth in Joseph E. Stiglitz & Andrew Weiss, *Credit Rationing in Markets with Imperfect Information*, 71 AM. ECON. REV. 393 (1981)).

118. See Engel & McCoy, *supra* note 117, at 1281-83, 1294 (analyzing the subprime lending market and the heightened susceptibility of minority communities to predatory lending practices).



takes place entirely through the mail. Because credit card lenders do not see their borrowers face-to-face, it is harder to engage in statistical discrimination or take advantage of gaps in social capital. The very impersonality of credit card loans, in this view, may be their principal virtue, their saving grace.

Credit cards do seem less prone to conscious forms of discrimination, but we need to be cautious before breaking into hymns of praise for the access to credit they provide. Even if credit cards are entirely free of the pernicious patterns we see elsewhere, impersonal credit markets are not the most satisfying solution to the legacy of credit market discrimination. The real victory will come when blacks are treated fairly and equally in face-to-face transactions, not just in more impersonal markets.<sup>119</sup>

Moreover, discrimination may affect even the impersonal credit card market in at least three important respects. First, to the extent credit card companies rely on credit scoring tests that consider a debtor's prior borrowing history, blacks will have more difficulty obtaining credit cards if their prior borrowing history is itself affected by discrimination. A black who overpaid for a car and later defaulted, for instance, may be denied credit. Second, credit card companies invariably require borrowers to provide their zip code. Given the extent of neighborhood segregation, zip codes could be used as a proxy for race. The final concern is, in a sense, a problem of too much access to credit card credit, rather than too little. Credit card companies make much of their money from fees for late payments and interest charges on carryover balances.<sup>120</sup> To the extent blacks disproportionately live in communities whose members have not traditionally had access to conventional credit, they may be relatively more likely to overborrow and find themselves carrying costly balances from month to month. They also may be less likely to know which fees they need to pay and which can be avoided. For example, if a borrower usually pays off her balance on a monthly basis, but accidentally pays late one month, most credit card companies will waive the late fee that would otherwise apply. But this benefit is only available if the borrower knows the system well enough to know she should call customer service rather than just shelling out the fee.

---

119. See Mary Anne Case, *Developing a Taste for Not Being Discriminated Against*, 55 STAN. L. REV. 2273, 2279 (2003) (stating that "by concealing race or sex, by making the transaction more anonymous and impersonal, [an Internet transaction] deprives . . . customers of what may be an important part of some people's taste for not being discriminated against—the opportunity to be treated fairly, respectfully, and as a welcome and valued customer").

120. See generally Oren Bar-Gill, *Seduction by Plastic*, 98 NW. U. L. REV. 1373 (2004) (analyzing the profit structure of credit card lending).

It is important not to lose sight of the benefits of credit cards. They provide significant and convenient access to credit for millions of Americans. It is also important, however, to recognize the dangers of this vast new market.

#### *D. Racial Dimensions of Bankruptcy*

As we saw earlier, the absence of a black bankruptcy bar was one manifestation of blacks' limited access to conventional credit in Sadie and Ray Alexander's day.<sup>121</sup> Seventy-five years later, we still do not see a black bankruptcy bar, but its absence no longer tells us quite as much as it once did about the relationship between race and credit. In the past twenty-five years, bankruptcy practice has shed its outsider status.<sup>122</sup> Rather than a Jewish bankruptcy bar or an Italian bankruptcy bar, we now see simply consumer and corporate bankruptcy bars.<sup>123</sup> As a result, the absence of a black bankruptcy bar is less worrisome than in the Alexanders' era.

Indeed, a leading black Philadelphia banker recently suggested that struggling black borrowers now seem just as likely to use the bankruptcy system as whites.<sup>124</sup> To the extent this is accurate, bankruptcy probably counteracts some of the problems we find in the credit markets. A debtor who has defaulted on her home mortgage may be able to use bankruptcy to cure the default and keep her house.<sup>125</sup> If the debtor overpaid for a car, she may be able to use bankruptcy to reduce the car's cost to its current market value.<sup>126</sup> This is hardly a perfect solution, given that bankruptcy only comes into play when a debtor is overwhelmed by her debts and that bankruptcy does not provide much help for a borrower who has used a home equity loan to repay credit card debt and later defaults. But it suggests that the bankruptcy process may make things better rather than worse.<sup>127</sup>

---

121. See *supra* note 28–31 and accompanying text (explaining that the lack of bankruptcy practice at black law firms was due to, among other things, the limited access that blacks had to credit).

122. See generally SKEEL, *supra* note 8, at 192 (describing the growth of the consumer bankruptcy bar starting in the 1960s and 1970s).

123. *Id.*

124. Telephone Interview with Ben Gilbert, President, Berean Bank (Mar. 17, 2004).

125. Even if bankruptcy itself is not a problem, the fact that so many black homeowners end up there is worrisome. See, e.g., WARREN & WARREN, *supra* note 109, at 159 (collecting data that suggest black homeowners are more than six times more likely to file for bankruptcy than their white counterparts, and Hispanic homeowners are three times more likely).

126. See *supra* note 82 (explaining how a debtor can "redeem" her car by paying the value of the car as opposed to the price for which the debtor purchased the car).

127. This is not to say that the bankruptcy rules are optimal. See *infra* Part V (considering

Is it possible that the bankruptcy process itself reflects the taints of historical patterns of lending discrimination? In the context of lower middle class borrowers who do not own their own homes, it may. Here is the concern: Consumer bankruptcy practice is a volume business.<sup>128</sup> Bankruptcy lawyers handle hundreds of cases a year and generally charge a set fee for each—\$500 to \$1000 or so for a simple liquidation, \$1200 to \$2000 for a repayment plan.<sup>129</sup> The need to handle a large number of cases means that they cannot spend a great deal of time on any given case. If financially troubled blacks are more likely than whites to have unconventional credit arrangements that might complicate the bankruptcy case, they might find it relatively more difficult, and more costly, to find a bankruptcy lawyer to handle their case. Legal services corporations such as Community Legal Services fill in the gaps to some extent by providing low cost or free bankruptcy services. These organizations, however, handle only a limited number of cases, and some focus their attention on Chapter 13, particularly cases in which the debtor is trying to protect a home.<sup>130</sup> We do not have nearly enough empirical data to make confident assertions about the racial dimensions of bankruptcy,<sup>131</sup> but it may well be that this is yet another context where the transition from nonconventional to conventional credit and the rise of credit card and subprime lending have had detrimental effects for black borrowers.

### V. *Conclusions and Implications*

Having spent so much of this Article exploring the continuing legacy of discrimination in the credit markets, let me begin this final Part by underscoring, once again, just how much progress has been made. A generation ago, banks red-lined black neighborhoods, and lenders explicitly

---

the shortcomings of the current bankruptcy law).

128. See Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 543 (1993) (noting that because "the fees in consumer bankruptcy are relatively low . . . a lawyer who wishes to make a good living needs a steady stream of new clients").

129. Telephone Interview with Eric Frank, Bankruptcy Attorney (June 17, 2002).

130. E-mail from Henry J. Sommer, Supervising Attorney, Consumer Bankruptcy Assistance Project, to David A. Skeel, Jr., Professor of Law, University of Pennsylvania Law School (Oct. 13, 2004) (on file with the Washington and Lee Law Review).

131. For the best evidence collected thus far suggesting that black homeowners are much more likely to lose their homes in bankruptcy than whites, see WARREN & WARREN, *supra* note 109, at 159. We are not yet able to answer many basic questions, however, such as whether blacks are more or less likely to file for bankruptcy than similarly situated whites.

discriminated against black borrowers.<sup>132</sup> Today, blacks have far more access to conventional credit than ever before.<sup>133</sup>

However, troubling evidence of discrimination remains, from higher rates of mortgage rejections to perversities in the automobile and subprime lending markets.<sup>134</sup> A bitter irony of the continuing discrimination is that much of it is linked, at least in part, to the very developments I have just praised.<sup>135</sup> Blacks have greater access to credit now, but their historical exclusion from conventional credit arrangements makes black communities particularly vulnerable to unscrupulous lending practices. Some of these problems may diminish over time, as access to conventional credit increasingly becomes the norm; the silver lining of transition problems, after all, is that they are transitional. But the evidence of discrimination, even after decades of antidiscrimination, suggests that it is not likely to disappear all by itself. What do the developments we have considered in this Article suggest about the way forward?

One implication is that structural reforms such as the Community Redevelopment Act are often essential for jumpstarting change.<sup>136</sup> Even if conscious racial hostility were eliminated, the lingering effects of historical credit market discrimination remain. The CRA has forced many lenders that never previously lent in minority communities to expand their focus and thereby has expanded significantly access to credit in many urban areas.<sup>137</sup> Its effect is complicated, to be sure. Competition from major national banks that are required by bank regulators to make loans in underserved communities can make it much more difficult for minority lenders to survive. For instance, an executive in Philadelphia's Berean Bank notes that his bank must compete

---

132. See *supra* notes 28–29 and accompanying text (discussing discrimination by banks prior to the 1970s).

133. See *supra* Part III (discussing the increased access of blacks to credit, due in large part to the advent of credit cards and subprime lending).

134. See *supra* Part IV (explaining that credit discrimination still exists, especially in the context of mortgages, subprime lending, and automobile lending).

135. See *supra* Part IV (explaining that the transition from nonconventional credit to credit cards and other more conventional forms of credit has made blacks susceptible to other types of discriminatory lending practices).

136. See *supra* notes 61–67 and accompanying text (discussing the CRA and the profound effect the Act had on lending practices in black communities).

137. See Elizabeth M. Iglesias, *Global Markets, Racial Spaces, and the Role of Critical Race Theory in the Struggle for Community Control of Investments: An Institutional Class Analysis*, in *CROSSROADS, DIRECTIONS, AND A NEW CRITICAL RACE THEORY* 310, 323–26 (Francisco Valdes et al. eds., 2002) (emphasizing the importance of the CRA in counteracting structural discrimination and criticizing recent legislation that weakened some of its requirements).

with banks that are much less concerned with carefully assessing their borrowers.<sup>138</sup> But small banks that are particularly well-attuned to their borrowers have traditionally been able to carve out a niche, even in the face of competition from large lenders.<sup>139</sup>

In addition to roiling existing lending patterns, the entry of large conventional banks into minority communities has come at the same time as abuses by subprime lenders, some of which have involved arms of the same national banks.<sup>140</sup> The CRA could be seen as having unwittingly abetted these practices by directing conventional banks into minority communities, enabling legitimate lending to provide cover for predatory practices. But the real problem is not the CRA and the sudden entry of conventional banks; it is the combined effect of the dearth of conventional lending in minority communities in the past and the vulnerability of borrowers in these communities to misbehavior by unscrupulous lenders in an era of transition. The CRA itself has helped to pump billions of dollars of new loans into communities that had been shunned by most lenders in the past.<sup>141</sup>

In addition to structural change, there also is room for narrower reforms. Of particular note in this regard is subprime lending. As we have seen, a disproportionate number of black borrowers wind up with subprime loans, even when they would seem to qualify for more attractive mortgages.<sup>142</sup> Subprime lenders also increasingly lend amounts well over the value of the debtor's home to borrowers who are very likely to default.<sup>143</sup> Existing bankruptcy rules make things worse by prohibiting a borrower whose mortgage swamps the value of her house from doing anything about it; she has no choice but to pay the mortgage in full or lose the house.<sup>144</sup> There is a

---

138. Telephone Interview with Ben Gilbert, President, Berean Bank (Mar. 17, 2004).

139. See generally Leonard I. Nakamura, *Small Borrowers and the Survival of the Small Bank: Is Mouse Bank Mighty or Mickey?*, FED. RESERVE BANK OF PHILA. BUS. REV., Nov./Dec. 1994, at 3.

140. A large number of complaints, and much of the recent litigation, has involved Citigroup. For a lengthy exposé of Citigroup's subprime lending, see Michael Hudson, *Banking on Misery: Citigroup, Wall Street, and the Fleecing of the South*, S. EXPOSURE, Summer 2003, at 22.

141. See Allen J. Fishbein, *The Community Reinvestment Act After Fifteen Years: It Works, but Strengthened Federal Enforcement is Needed*, 20 FORDHAM URB. L.J. 293, 298 (1993) (crediting the CRA with \$30 billion in total commitments to poor communities).

142. See *supra* note 105 and accompanying text (stating that 50% of all refinancing loans made to blacks are at subprime rates).

143. See, e.g., Moss, *supra* note 87, § 3 at 1, 9 (giving examples of this practice).

144. See *supra* note 82 and accompanying text (discussing how a homeowner must pay the full value of the mortgage in order to keep the house, unlike other interests in property that can be reduced to the value of the property).

simple solution to this aspect of the problem: change the rule. If debtors could scale down their mortgage to the value of the house, as they can with other assets, subprime lenders would pay a price for making loans that are not supported by the value of the house.<sup>145</sup>

Another possible remedy might be to impose a federal ceiling on interest rates. Lenders cannot induce borrowers to borrow money at exorbitant rates, the reasoning goes, if the permissible rate is capped.<sup>146</sup> Here, however, the benefit would come at a significant cost. Faced with restrictive usury rules, lenders can be expected to cut back on credit. This could have the effect of steering marginal borrowers who need credit toward much less attractive forms of credit, such as pawnshops or even loan sharks. While permitting states to experiment with usury regulation might make sense, a blanket rule might do more damage than good.<sup>147</sup>

Neither of the reforms just considered is aimed directly at discrimination in the subprime market. The intuition is that general subprime lending reforms would benefit all subprime borrowers, both black and white. For discrimination, the most plausible legal response is to continue to frame class action litigation as abuses come to light. The past several years have seen major settlements involving General Motors and Nissan.<sup>148</sup>

Sadie and Ray Alexander fought to give blacks the same access as whites to hotels, movie theaters, and other public accommodations.<sup>149</sup> The struggle to assure fair treatment with mortgages and car loans has far less drama, but there is nearly as much at stake. In our day, access to credit is a crucial source of the opportunity for which DuBois longed, a way both to encourage and "reward honest success."<sup>150</sup> But that same access is a source of sorrow for

---

145. See David A. Skeel, Jr., *Bankruptcy's Home Economics*, 12 AM. BANKR. INST. L. REV. 43, 48–50 (2004) (proposing a reversal of the special treatment under the bankruptcy law for home mortgage creditors).

146. For recent defenses of usury regulation, see generally Elizabeth Warren, *The New Economics of the American Family*, 12 AM. BANKR. INST. L. REV. 1, 38–40 (2004); Vincent D. Rougeau, *Rediscovering Usury: An Argument for Legal Controls on Credit Card Interest Rates*, 67 U. COLO. L. REV. 1, 41–42 (1996).

147. See Skeel, *supra* note 145, at 50–53 (recounting the potential costs and benefits of usury law reform and concluding that caution is warranted).

148. See, e.g., Danny Hakim, *Study Says Blacks Paid More for Honda Loans*, N.Y. TIMES, July 28, 2004, at C6 (stating that the lending arms of Nissan and General Motors have already settled lawsuits for discriminatory lending, and other suits are pending against banks and financing companies operated by Ford Motor, Toyota, and DaimlerChrysler).

149. See *supra* notes 55–58 and accompanying text (describing the role that the Alexanders played in the Civil Rights reform in the 1960s and 1970s).

150. DuBOIS, *supra* note 1, at 397.

many—sorrow that stems in no small part from the discrimination that continues to distort the market for credit.

Because this is a symposium on Critical Race Theory (CRT), let me conclude with a note about the future direction of CRT scholarship. Throughout the Article, I have deliberately incorporated insights and strategies from both CRT and economics-oriented scholarship without drawing sharp distinctions between them. The assumption that these perspectives can inform one another is controversial,<sup>151</sup> but it is also, in my view, the way forward. Through wrenching personal narratives and more explicitly theoretical analysis, CRT scholars have shown us the pervasiveness of discrimination and what it feels like. Economics-oriented insights such as social capital theory and credit rationing offer complementary explanations for the persistence of discrimination, and recent empirical studies provide startling evidence of its magnitude even in settings where it seems least likely. Separately, the CRT and economics-oriented perspectives each make a powerful case. Together, they could lead to real change.

---

151. Indeed, an entire volume of the *Stanford Law Review* was recently devoted to the debate. See generally 55 STAN. L. REV. (2003).