

AMERICAN PREDATORY LENDING AND THE GLOBAL FINANCIAL CRISIS

ORAL HISTORY PROJECT

Interview with

Thomas James

Bass Connections

Duke University

2020

PREFACE

The following Oral History is the result of a recorded interview with Thomas James conducted by Andrew O'Shaughnessy on June 29, 2020. This interview is part of the Bass Connections American Predatory Lending and the Global Financial Crisis Project.

Readers are asked to bear in mind that they are reading a transcript of spoken word, rather than written prose. The transcript has been reviewed and approved by the interviewee.

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Interviewee: Thomas James
Interviewer: Andrew O'Shaughnessy

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Andrew O'Shaughnessy: My name is Andrew O'Shaughnessy, a J.D. candidate at the Duke University School of Law. I am also a research assistant for the Global Financial Markets Center's American Predatory Lending Project. It is Monday, June 29th, 2020. I'm speaking remotely with Thomas James to conduct an oral history interview. Mr. James, thank you for joining me today.

Thomas James: You're quite welcome. Thanks for inviting me.

Andrew O'Shaughnessy: Of course. So I'd like to start by establishing your background. I understand that your first job out of school was with the Leadership Council for Metropolitan Open Communities in Chicago. What did you do there and what led you from that to law school?

Thomas James: ... To answer your question about my work at Leadership Council before law school, as a housing counselor, I worked in what was called the Gautreaux Program, which is part of the relief for a case brought by a tenant in the Chicago Housing Authority that sued the Authority and the Department of Housing and Urban Development over the redlining that had occurred – the redlining by race.¹ That is the racist redlining that had occurred in the Housing Authority in placing tenants in housing that was a hundred percent African-American and segregating that population from the rest of the population in the city.

And part of the relief under the Gautreaux Program [that] the court granted was what was called a "metropolitan-wide remedy," which allowed tenants in the Authority to opt for paying Section 8 housing subsidy certificates, which could be used to rent private market housing on a metropolitan-wide basis. So I was assisting people who were living in segregated housing to find housing outside of neighborhoods that they had been confined to. I think over our span of a couple of years, I probably helped a hundred or so families find housing that was in most cases outside the city limits, and [with] school systems

¹ This class-action suit sparked decades of litigation. See, e.g. *Gautreaux v. Chicago Housing Authority*, 304 F.Supp. 736 (N.D. Ill.1969) (issuing judicial order to Chicago Housing Authority to provide relief for policies promoting racial segregation of public housing).

that were really pretty good and in labor markets that were thriving.

Andrew O'Shaughnessy:

What did you find the results were for the folks that you resettled? Did you have an opportunity to keep in touch with them?

Thomas James:

Well, I didn't, myself keep in touch, but there've been a number of studies over the years that have followed people who made that move. And, by and large, I think that the families that could make the adjustment really did thrive under the program. But it's been a while since I've looked....

Andrew O'Shaughnessy:

So what led you from the Leadership Council to law school?

Thomas James:

There were limits, of course, on what I was doing, and I was interested and had been interested in going to law school. And I thought that at some point I just had to make the break and go for it. I think I was twenty-four [or] twenty-five when I applied. So I've been doing the housing counseling work for some time. But I thought getting a degree in law would be a little more impactful. So that inspired me to apply.

Andrew O'Shaughnessy:

And then what led you from Berkeley to the Illinois [Attorney General's] office?

Thomas James:

I graduated almost 40 years ago, and, at that time, the University of California system was basically free. There were certain fees, but I think, believe it or not, it ran something like \$350 a semester to attend, and I had a small fellowship. So I really graduated without any debt. And I had a very wise professor who suggested to me that – since I was getting out of law school with no debt – I should pass the bar and go into practice. And so that's what I did initially. I passed the bar in California, and I came to Illinois. [The] California bar doesn't really have reciprocity with other states. I needed a license that I could use in more than one state. So after I passed the California bar, I came to Illinois, my hometown [of] Chicago, and passed [the bar] here.

And at that point, there was a political movement here around actually getting people access to the ballot. And I got involved doing that in addition to having a very small private practice, doing the bread and butter stuff that small practitioners do – wills and divorces and estate planning and a little [personal injury]. But there was a political movement here to get people who had pretty much been precluded from access to the ballot

to get on the ballot. So we were bringing cases that kind of broke the machine down, or at least loosened the iron grip [that] it had on ballot access. And eventually we ran a guy named Harold Washington for mayor, and he won, and it was kind of a revolutionary moment here in Chicago with respect to the politics of things.

Andrew O'Shaughnessy:

How long were you in private practice doing what you described? And then what was the transition into the AG's Office like?

Thomas James:

I was in private practice for over six years. And one of the cases I had as I built up my practice – one of the suburbs of Chicago, Evanston, had historically been a[n] African-American community that was segregated [in a] Jim-Crow fashion. And as part of that segregation, there was the Evanston Hospital for the general population, and then there was the Community Hospital of Evanston which served the African-American community. So there had been two hospital systems, as many things were in Jim Crow. And that hospital – when the Civil Rights Acts were passed and there was desegregation, the African-American population migrated to the better conditions [that were available] in the Evanston hospital. And the Community Hospital of Evanston started to languish, and it was really captured by some lawyers who were also criminals, I think.

And they started to load the beds up with phony cases just to generate insurance claims. And there were a number of people on the board of the hospital – it was a charitable organization – that were unaware that this was going on. At some point the Attorney General's Office stepped in because the Attorney General has charge of charitable trusts, ultimately, and [they] stepped in and sued those individuals and also sued the board. I was hired by a member of the board to defend the people on the board. And that brought me in contact with the Attorney General's Office.

In the course of working out a settlement for that predicament, I got to know individuals at the Attorney General's Office and work with them. And a friend of mine also had gone from Berkeley into the Attorney General's Office and was moving up the ranks there. And at some point in 1988, the then Attorney General, Hartigan, wanted to open a regional office, a small storefront office, on the South Side of Chicago in a predominantly African-American community. I was approached to join the staff and run that regional office out of a storefront down on the South Side.

So that's brought me to the Attorney General's Office. I backed into it, and I never thought I'd be in law enforcement at all, but that was such an intriguing offer. And the Office of the Attorney General has so many types of jurisdiction and so much authority to do proactive, progressive social policy that I – and given that neighborhood and all of that – I couldn't resist the urge to join. So I did.

Andrew O'Shaughnessy:

Were you working exclusively in consumer protection when you started, or did you have more of a generalist role when you began?

Thomas James:

My office was a service office, and people could walk right into the door and file a complaint or seek information. And I was also situated in a very – the office location in the neighborhoods on the South Side where we were situated were historically African-American and... were the product of segregation. And there were all the urban problems that confront neighborhoods that went through that kind of history. So we had all kinds of fascinating challenges that ranged from – well, I spoke about the charitable trust problem that I had encountered in Evanston. On the South Side, we had those sorts of problems with charities that had fallen into the wrong hands. There were abuses of charitable assets. We also had enormous environmental concerns there. The aging infrastructure of the industrial revolution was in large part housed on the South Side of Chicago in the form of steel mills and rail yards, which were languishing, and there were problems there.

So there were those types of things, and then there were enormous consumer issues too. Because there was a very underserved community, underserved by banking and financial interests. And there was always a housing crisis going on – still is – and the ability to get investment into the community has always suffered enormously from, I think, neglect. So the office was pretty busy with all kinds of problems that we were trying to address. So I brought some environmental lawsuits, and I brought charitable trust lawsuits, and I brought consumer lawsuits.

At the time – all neighborhoods go through evolution. African-Americans had gained access to the mortgage financing after the passage of the Civil Rights Acts in the mid '60s. And so this was twenty years later. A lot of those mortgages were now twenty years into a thirty-year term. And there was a lot of equity that was built up and the homes of the people in those communities who had been able to purchase twenty years before in the late '60s [or] mid '60s. That pent-up equity

became a real target of predators who were very busy figuring out ways to exploit that equity, if they could find a[n] entree into the consumers' trust or confidence.

And so early on, I think I became aware of abuses that were evolving in that community, particularly among mortgage brokers. When I first started practicing, I [had] never even heard of a mortgage broker. I did many, many, many closings when I was in private practice, and I had never run into a mortgage broker, but they started to pop up, really, in the very late '80s, and their population grew into the '90s. And they became a real problem because they were acting as intermediaries between banks and non-bank financial institutions and consumers who had equity in their homes. And they were very willing to exploit that relationship in order to finagle money from people who had no idea how to protect themselves in that situation.

Andrew O'Shaughnessy:

What sorts of abuses you were seeing at that time? ... [W]as it a question of there [being] good and bad brokers, or did it seem like the whole business model was problematic to you?

Thomas James:

Well, as I said, I had been practicing as a private attorney, and I had handled many, many closings in the early days of my practice, and I had never really bumped into a mortgage broker. And so my first reaction: what was their utility as a participant in the transaction? What did they bring to the table of intrinsic value that wasn't already there? So I did have some deep suspicion with respect to the value of the services that they were offering. I think the industry got the licensing law passed in '87 or '88 in Illinois. And so they were certainly able to throw around their weight and in the legislature. They got licensing, and then they started to appear at closings, and they also would pick up a large chunk of cash in the process. I was no longer representing private individuals, but I was very dubious about, again, the social utility of what they were bringing to the market.

And I started to see real abuse emerging, especially in the African-American community. I can't remember the year, but it was probably in the early '90s or the mid '90s, probably '94, something like that. I became aware of mortgage brokers who were going door to door on the South Side and getting consumers to sign contracts, mortgage broker contracts. These were exclusive contracts that bound consumers to the mortgage broker for up to a year's time so that if, for any reason, the consumer used their home as a security interest in obtaining credit, these contracts said the mortgage broker was entitled to ten to twenty percent of the amount borrowed. So

really predatory stuff in door-to-door sales. People had no idea what they were signing. These contracts were egregiously unfair.

And I brought a series of lawsuits. In fact, there were so many [predatory mortgage brokers] out on the street that there was no way I could sue them all. And I remember I was down on the South Side, [and] I'd go downtown to tell my bosses what I was up to. And I came in downtown [and] had drafted five complaints. I had selected five of what I had detected as being the most notorious, at least that I was aware of. And I had proposed that I sue five [of them], or that the office sue five.

And they said, "Well, five?" I said, "There are hundreds out there, but this would send a signal to the industry that at least there was a cop on the beat." And so we sued the five and the mortgage broker industry here went wild, because they saw this as an enormous threat. Actually we sued them under the FTC [Federal Trade Commission] rule on door-to-door sales. There wasn't really anything in place, particularly, to address the problem. So it was [a] strange application of the FTC door-to-door rule, but nevertheless it did the trick and it sent a message to the industry. But that was just the beginning of a problem that was going to metastasize eventually, and, I think, lead to one of the causes of the financial collapse that we had in '08. That was the first case where I really thought there was a problem that was going to spiral out of control.

Andrew O'Shaughnessy:

And the problem at this point was the predatory actions of these brokers who were extorting outrageous fees, essentially, from regular mortgage transactions?

Thomas James:

Right. So there was a combination of problems. One was that these neighborhoods were underserved by banks and financial institutions. I think at the time there were three banks that I was aware of on that entire South Side serving a million people. Ridiculous. So you had pent-up demand. You had a population of people who had historically been the victims of segregation and the victims of the absence of banking and financial services. So the population was unfamiliar with how mortgage products worked and what was conventional. There was no ability to discern between products. There was no history of relationship[s] with banks and financial institutions. So there wasn't an awareness – you had consumers who were fundamentally naive about the subject matter. So it was easy to take advantage of them, in terms of selling them a very complicated financial product. The vanilla thirty-year, fixed-rate mortgage, [which] was about the only product available at the

time that the Civil Rights Acts were passed, had evolved over time.

We went through the ... the stagflation crisis. And [in] the early '80s, when I got out of law school, my first closing was for two young lawyers who had just been married. I think they were both [in] silk stocking law firms and they could afford to take the mortgage out, but I think I closed that mortgage at a rate – the rate then for A-credit people was eighteen percent. So we had gone through – that crisis precipitated the development of new and different kinds of financial instruments, [such as] mortgages, that were very unconventional. And [there were changes] in terms of the thirty-year fixed that had been kind of the watermark for so many years for generations of people. So as these products emerged, there was enormous opportunity to abuse the unwary consumer and to sell them an inappropriate product that would harm them rather than do them good.

Andrew O'Shaughnessy:

What were some examples of these novel terms?

Thomas James:

Well, they really ran the gamut. The first that I remember emerging were just adjustable-rate mortgages. So instead of having a fixed-[rate] for thirty years, which had been the convention, these mortgages were thirty years, but the rate adjusted and varied with some market index. So oftentimes it was the LIBOR, the London Interbank Offered Rate, that banks use to do overnight lending to one another. That was the index that many of these instruments were pegged to. So you had a rate that would float, so there was a risk [that] the consumer was taking on, of course, that rates would rise. And if they had budgeted for a given rate and the LIBOR index forced the rate above what they had budgeted for, they would be in financial trouble, and in all likelihood unable to make their payments and possibly go into foreclosure. So that was the first that I became aware of the adjustable-rate mortgages.

And then there were products that also had always been there. These products had probably always been around in one form or another for very sophisticated market players, but they were not in general circulation, certainly when I started practicing. But the financial crisis of the '80s saw the emergence of things like [adjustable-rate mortgages]. And then there were also balloon-payment mortgages. So these were mortgages that had a term that was shorter than the traditional thirty-year term. And they could be five years, they could be ten years, fifteen, et cetera, but essentially they didn't amortize completely by the end of the term. So at the end of the term, the borrower was forced to come up with whatever the balance that was still

outstanding on the loan happened to be, which was fine if you were able to access credit markets easily. But if there was friction – for instance, if you happened to be African-American – there would quite likely be a problem in locating a financial institution that was readily going to lend you money.

So there were problems that were endemic to the community I was serving that had to do with access to credit. And then there were problems with the familiarity of people using these complex products, and products grew ever more complex as time went on, until the financial collapse.

And those products are only now starting to reemerge, by and large very little, but they're starting to reemerge again. It's been over ten years. There were none available in the market for years after the collapse, but they became more and more exquisitely difficult and opaque – complex, difficult to discern, and opaque in every way as time went on leading up to the crisis. There were things we called “pick a pay” where the mortgage might amortize, [or it] might reverse amortize, depending on what LIBOR was doing and what the borrower was able to pay. So these products got very, very complex and inscrutable for the average consumer.

Andrew O’Shaughnessy:

You said – was that “pick a pay?”

Thomas James:

Yes. Pick a pay.

Andrew O’Shaughnessy:

Could you describe what that was?

Thomas James:

Sure. That was a mortgage that was [offered by] the darling, Countrywide, which was, I think, the largest subprime mortgage platform that collapsed at the time of the financial crash, or just before the collapse, just before the crash. But that product was one that offered the consumer, the borrower, the so-called choice of: you could pay it in the traditional way with a traditional amortization schedule that would pay off over thirty years, or you could pay less than the amount necessary to amortize it over the thirty-year period (or whatever the term of the loan was) and essentially put yourself in a position where you were going to face a balloon at the time that term ended, or you could actually reverse amortize the things, which meant that the principal amount of the loan would grow over time, as opposed to amortize over time. So by making a payment less than the amount necessary to amortize the loan, you actually went further and further into debt over the term of the loan. Well these were terribly complex products that, if a consumer

didn't understand how they worked, could lead to trouble very quickly, and they did.

Andrew O'Shaughnessy:

You mentioned [that] in the '90s, you were bringing cases under FTC rules because you didn't have a variety of legal tools to go after them. I'm curious, when the mortgage brokers associations got upset when you brought those five cases, what did they do, if anything, to try and limit the causes of action you had? And then did the regulatory regime catch up with the market at all? Did you get access to tools that allowed you to take a more systematic approach to taking on this sort of abuse?

Thomas James:

Well, interestingly enough... most states have what are called mini-FTC acts.... So we have these UDAP laws, Unfair and Deceptive Acts or Practices laws, and they are consumer protection laws that mirror, in many ways, the Federal Trade Commission's operative statute. And we had a similar law here in Illinois, which was a door-to-door provision – we had codified the Federal Trade Commission's rule as state law. And the mortgage brokers actually went to Springfield and exempted themselves from that law. That didn't exempt them from the FTC Act, which they probably didn't understand, but they did go and try and undo my work down in Springfield, in our state capital, and managed to exempt themselves from the door-to-door provisions of our state law. So there was, yes, an immediate reaction to what I had done at a legislative level.

But our office also got involved in lawmaking and in trying to get the legislature to pass laws. One of the first ones we did was a High Cost Home Loan Act that we fought for a while, but we got it into place in '04. So that was about four years before the crash, but we were already very worried about where things were heading, worried enough so that we pushed [for] and got [the law], which, in a lot of ways, mirrored HOEPA, the Home Ownership and Equity Protection Act, which had been passed almost a decade earlier as part of the Truth in Lending Act. And that Home Owner[ship and Equity] Protection Act was a federal statute that was designed to curb a lot of the abuses that had been observed in the marketplace up until that time. So clearly things were bubbling up enough in 1995 to cause Congress to take some action.

But HOEPA was very limited and a high cost loan was very expensive, though we sued FAMCO, First Alliance Mortgage Corporation, under HOEPA. So we actually brought a HOEPA action in the history of the run-up to the collapse. But the triggers that brought HOEPA into usefulness were very high.

There were triggers for the amount of origination points and other charges usually charged by mortgage brokers in the origination of a loan. And those triggers were very high. And there were also interest rate triggers, which were also very high. And you could effectively engineer your product to have rates and fees and costs that were just under the very high triggers of HOEPA and therefore be exempt from the law. Except in the case of First Alliance, where there was pretty much a disregard for limits when it came to charging brokers' fees. Particularly, they blew the thresholds on HOEPA and we sued them under HOEPA in addition to suing them under our own unfair and deceptive trade practices act.

I'm trying to think of the chronology here. I remember the FTC did a training on HOEPA in, probably, '96. They came out to Chicago and many of the [Attorney Generals'] staff in the region [attended] – so we had Iowa, [we] even had, I think, folks from Minnesota and Massachusetts here – because the FTC gave a[n] all-day conference on HOEPA and its significance and how it worked and what it was meant to do. And I attended that. So I saw a number of AGs there that were at least scouting for this emerging market anomaly that was problematic.

And I think by the next year, I was in my office when a couple walked in, and they were [an] Eastern European couple. They were naturalized Americans, but they had come from, I think, Czechoslovakia and moved to the United States during the Cold War, came from behind the Iron Curtain to Chicago and started working as janitors. And over the years, they had managed to buy a series of two flats, which they rented out. Little apartment buildings. They had probably about fifteen little apartment buildings with two or three units in each building when they walked into my office. The guy was carrying a briefcase and he opened it up. He put a pile of paper on my desk, and it was mortgage papers. I looked at them, and he said to me that he thought something was wrong, but he didn't know what, and that's why he was in the office. I thought, "Okay, I'll take a look that."

And I read through the mortgage paper in this First Alliance mortgage, and it had a loan origination. I think the mortgage was for \$110,000, something like that, and a loan origination fee of \$22,000. I explained to them what the paperwork said and what it meant. And I remember the woman started to cry. So we had a long conversation about how they did business, and they were actually in the shadow economy, in a way, because the way they operated was fairly unsophisticated. They used a credit card to pay for the repair work on all their units

and to pay for the capital goods. If they had to replace a furnace or air conditioner or whatever they had, they would use this credit card, and when they got thirty or forty or \$50,000 on a credit card – so short-term, high-cost credit – they would refinance one of their buildings. So they had done dozens of refinances. And somehow they got snookered into a \$22,000 origination fee on a \$110,000 mortgage. So I thought, “Oh, this is a real – this is a confidence game on a level I haven't seen.”

And so I went downtown and went to the regulator that licenses mortgage brokers. And I had their paperwork with me and I said, “Do you have any complaints on this outfit?” They said, “Yeah, we do.” They had thirty-three or something. Thirty-three. I couldn't believe it. I looked through those files and they were all the same complaint. Twenty percent loan origination fees. And I asked them – this is part of the problem, part of the problem was regulatory. So I asked them, “What's going on here?” And the response was “The paperwork's completely clean. They're not doing anything wrong.” I said, “Well....”

Anyway, I had a long conversation with that couple from Czechoslovakia. And we talked about how they were sold the loan. And then I started to call other people in the pile who had complained but had their complaints turned away by the licensing agency. And as I interviewed victim after victim, the sales scenario started to become clear. And there was a masterful presentation that was deceptive to the core, but it was beautifully orchestrated. And eventually, after suing them, I started doing depositions of the salespeople, the sales force. And the sales force had been selected from among car dealerships. And so you had to be a car salesman, essentially, before you could be a mortgage broker working for FAMCO. And then they selected them primarily from the finance managers at car dealerships, who would – they're the last person you see before you get your new car. And they're the people who try and sell you what we call the back-end products. So these are not the car, but the financing, the warranties, the etching, whatever it is that you don't really need, but they're happy to have you pay for. So they drafted the sales force from among that sort of a targeted population. And then they shipped them out to California for a week or two for a training camp where they taught them all about how you disguise [the predatory nature of the loan] by using the federal disclosures on the TILA form. [That was the practice back] then. ... [P]ost-crash, this is all changed.

But the forms for disclosures at the time actually didn't do two things. They didn't tell you the interest rate on the loan, so you

actually couldn't look at the disclosure and figure out what the interest rate was. They disclosed what was called the APR [Annual Percentage Rate] – still around today, but it's a different measure. And by some very neat trickery, you could hide a twenty percent loan origination fee using the federal disclosure. So they had masterfully invented what they called – I think it was called the “monster trap.” And that was the sales performance these guys would use. It ran about an hour, and it would flummox people and get them to sign this paperwork.

I do recall asking him, “Well, how many people figured out what's going on?” It was about fifty percent. Fifty percent of people got wise to it. And they called that a “blow-up on the docks” because oftentimes people would get so angry they'd throw stuff in the sales room, when they figured out that somebody was trying to cheat them out of their home. They call it “blowing up on the docks.” Anyway, so about fifty percent – they had a pretty sophisticated targeting operation. I went out, saw one of their offices, and I certainly deposed a number of their salespeople in the course of litigating. But, before I sued them, we interviewed all of these victims and kind of started to reverse engineer the sales presentation and the fraud.

And at the time, Sears Roebuck, which was housed here in Chicago, had run into a big problem in their collection arm, and there was a scandal involving their reaffirmation of bankruptcy debt outside the court process, which was quite illegal. And a bankruptcy judge in Massachusetts became aware that this was going on. And the judge was pretty angry and wanted Sears to respond. I got a phone call from downtown saying, “Tom, you need to fly out to Massachusetts. Sears is in trouble. They're our corporate citizen. Can you help go and be present at the negotiations on serious misbehavior?”

So I went out to Massachusetts and I brought my – I was still drafting the First Alliance complaint. And I brought it out when I got there. I asked around their offices [whether] anybody was doing mortgage work. And I found a lawyer there, Pam Kogut, who was, and I gave her my draft complaint and said, “You may have a problem here, too. Read my complaint, see if you've got First Alliance operative in your jurisdiction.” And so she did. And she called me back and said, “Yes.”

Once we realized that was a national problem, then we kind of put out the word, I forget how, but Prentiss Cox up in

Minnesota was working at it already.² And Prentiss had a – I can't remember the guy's name, but Prentiss had discovered a loan officer. So there was a whistleblower. His first name was Greg, and I can almost get his last name. But he had developed a crisis of conscience, and he gave Prentiss a call. I had my complaint drafted, [and] Pam had her complaint drafted, and all of a sudden – manna from heaven – we've got an insider.

So we sued. We all sued. I had come in under a Democratic administration. That administration went out. I was in my sixth or seventh year at the office when First Alliance got onto my radar. And I was working under a Republican administration now, and it was quite pro-business. And the Attorney General was a very honorable person, but his political persuasion didn't exactly tilt the office into aggressive consumer work necessarily, especially if it involved taking on large, very established financial institutions. So I felt as though I was on delicate diplomatic turf internally in my office in terms of selling a lawsuit, internally. And [it] was very helpful to have other states initiate their litigation before I did, because it gave me the opportunity to point to the fact that there was a widespread problem. And I was allowed to file a lawsuit, and did, so we were now litigating in three states in our state courts.

And during my research, I had discovered that there were some class actions out in California. Sheila Canavan, who you have to talk to, had brought some lawsuits there because – she had brought them, I think, as the elderly abuse cases. And when I looked at First Alliance's SEC [Securities and Exchange Commission] filings, and also I interviewed thousands of people in my state, [I concluded that] they were targeting people. I think the average age was sixty-six or sixty-seven of their victim. So they were certainly targeting a vulnerable population. And that's an aggravating count under our consumer fraud act, too. I think I brought that claim also. But I contacted Sheila, and she was under a gag order. I thought, "Oh, she really couldn't talk to me." But I – then, this was before I had found Prentiss or Pam, but that's when I knew it was a real national problem. She was under a gag order. So she couldn't talk to me, but I knew there was trickery afoot in all sorts of places.

Eventually we also got, I believe, Washington. Washington's banking agency, a guy there named Chuck Cross, was also wise to them and had, I believe, brought an administrative action against them. But we had not coalesced into what we call a

² See the APL Project's interview with Prentiss Cox at <https://apl.reclaim.hosting/oral-histories-2/prentiss-cox-former-minnesota-assistant-attorney-general/>.

multi-state. We were each, in our own individual jurisdictions, suing them. But as the heat got turned on, the First Alliance lines of credit... which were... I think Lehman was the biggie that sticks out in my memory. Lehman was funding the originations, and then, I think, packaging the mortgage papers for resale on Wall Street.

Andrew O'Shaughnessy: When was this, at this point?

Thomas James: I sued them in '98. '97 or '98, but I had been putting the case together for a year because there wasn't really a template for doing that.

Andrew O'Shaughnessy: ... I wanted to follow up on something that you had said, which was that even then in the late '90s, Lehman was providing financing in order to produce financial derivatives for resale.

Thomas James: Yeah. Now I don't know if they – I can't remember if they were actually doing the packaging or they were just doing the – I'm sure; [it] would shock me if they weren't also doing the packaging. I'm almost sure they were, but I know that they were doing the lines, advancing the credit. And I know they were aware, of course, that it would end up being [packaged]. I can't imagine that they weren't in both the front end and the back end, as they say. But I'm sure about the front end. And I'm relatively certain about the backend.

Andrew O'Shaughnessy: Okay.

Thomas James: I just know that wasn't part of the litigation. And so I was never able to do a deep dive into that. And that had to do more with internal – with the reluctance of my office to pursue. I advocated very strongly that we pursue Lehman as part of the First Alliance. And my office was very, very reluctant to do that, and I never got the approval. I sought to go into the secondary market, but that was later on. I was seeking that approval after I had been able to – we, not I – because at the point where we got this – well, things got complicated, so I'll back up a little bit.

So this is the end of the last century. So we're '99 or so, '98 [or] '99, where the three of us are locked in litigation. And I think Chuck Cross has got administrative action out of Washington, but Pam Kogut is in Massachusetts, and Prentiss Cox in Minnesota, and I'm here. And we're also in state courts. And I had not, at that point, put a HOEPA claim – that is, the federal Home Ownership and Equity Protection Act claim – because I didn't want to be removed into federal court, I wanted to stay in

our own state courts. But we got a call from one of the Saturday night or Sunday night [primetime shows]. I think it was Frontline, I forget, but it was one of the big muckraking national TV shows. And they had read our complaint and they wanted to do a piece and they wanted to feature my Attorney General.³ And so they came out and did a big interview with him, which is going to hit the national spotlight.

And the *New York Times* was in cahoots with them and they did a simultaneous front-page expo. And so there was a double whammy. They ended up on national news on a big segment that ran fifteen minutes, and they also ended up on the front page of the *New York Times*.⁴ So they were a pariah overnight, and within a week they filed for bankruptcy in the Central District of California.

So we were stayed, actually under federal law, under bankruptcy law. We're not supposed to be stayed, but we got stayed anyway. We were stayed, and at that point we had to go into the bankruptcy court if we were going to pursue the litigation. Prentiss was able to settle with them. He had far fewer loans than we did, and he could – this was before the bankruptcy was filed. So Prentiss was able to settle out many of his claims and get very favorable relief for his consumers. But I was in a much deeper quagmire, and I had to go after them in the bankruptcy court. Because I really thought that we had to go after Lehman, where the big money was, because First Alliance – even though they filed bankruptcy with \$150 [million], or maybe \$180 million in the black – they had caused so much damage that wasn't going to cover it.

Andrew O'Shaughnessy:

So they filed bankruptcy in anticipation of their liability, not because their credit lines dried up? Or was it both?

Thomas James:

I think it was both. And so we changed gears and were out of state court, and we went into the federal bankruptcy court and pursued the litigation there, and we were very aggressive. And so now it was Pam Kogut and I, so Massachusetts and Illinois showed up first. Than New York showed up, and Florida, and California was very late. The bankruptcy judge was beside himself with their lack of presence. But they eventually came in. Very good lawyers from California came in. So eventually we backed into a multi-state by virtue of the bankruptcy....

³ James is referring to ABC News' 20/20 Special Report: Mortgaged Lives.

⁴ MORTGAGED LIVES: How First Alliance Profits From Fine-Print Lending With Wall Street's Help
Henriques, Diana B. [New York Times \(1923-Current file\)](#); New York, N.Y. [New York, N.Y.] 15 Mar 2000: A1.

I had gone out to help negotiate the Sears settlement in Massachusetts, which was kind of a multi-state, but this was really a multi-state. We had a slew of states in, finally, and we were able to really – First Alliance had a lot of money and they were well represented. We did battle for at least the better part of two years before we settled. In that time, we got discovery and we got into some of the Lehman correspondence. Lehman had sent due diligence people out to basically examine First Alliance. And they had reported back that they thought the operation was essentially a fraud, but that it was highly profitable. If they weren't violating the law, they were walking the edge, and they were certainly violating the spirit, I think is what this correspondence said.

So I thought we had enough to go after the Lehman, but every person is bound by their circumstance, and my office just wasn't willing to second guess Wall Street. And that was problematic throughout, I think, all kinds of enforcers' thinking at the time. Some of us were very aggressive, who were very upset by what we saw happening. We thought before anybody else did that we were on the road to disaster, but it was very hard to move the consciousness of people who were rooted in the status quo. So we were up against an insurmountable barrier there.

Andrew O'Shaughnessy:

.... Were there any states to your knowledge that did pursue that connection? Or was there none? Were other jurisdictions similarly tied up?

Thomas James:

I'm going to ask you to clarify your question because I'm not sure I understood.

Andrew O'Shaughnessy:

Sure. In your case, you mentioned that the political situation [with] your AG made it difficult to pursue the Wall Street connection. Prentiss Cox mentioned that he felt he had a fantastic case against FAMCO and didn't want to complicate [it], and it was kind of his first big one. That's how he was thinking about it. But you mentioned Pam [Kogut] in Massachusetts and Chuck Cross in Washington. Are you aware of any jurisdictions that did pursue the Wall Street connection at this point?

Thomas James:

No. We were very cutting-edge in this so people weren't – It was Sheila Canavan who suggested to me that, in order to shut this emerging cancer down, you had to go to the source, and the source was Wall Street. And the minute she said it, I knew it was right. I had read all the FTC filings, so I knew that they were sourcing their money on Wall Street, but then when we found that [Lehman] documentation, that Wall Street was in on it, I thought we – but at the time that was “my eyes only,” or not

my eyes only [but rather only available to] the litigation team. We were staring into this paperwork, and it was confidential, or could have been. We weren't sure about the con[identiality].

I was ready to go, without my boss's approval, to go to the press or – I couldn't – I could draft a lawsuit, but I had to get the green light. Meanwhile, the other thing that you have to realize is that if the problem isn't recognized for its gravity and severity, it isn't addressed that way. And all these bureaucracies – I work in a bureaucracy – have to manage all kinds of competing demands. And it's very unusual, at least in my experience – and, I think, it's very unusual in the experience of our office – to be fielding an attorney, an Illinois [Assistant Attorney General] in a California court. I mean, they were shipping me across the country. I had to have the hotel room. We're designed for our limited space inside our states. And so the concept of taking on Wall Street was really not in the then perceived toolbox. So litigating a complex matter in a foreign – we were in federal court, but physically in a foreign jurisdiction – was very unusual. And so it was impossible to get the bureaucracy to take more than the baby steps. So there were certain of us who were very aware that to shut it down, we needed to be able to get at Wall Street to cut off the spigot. But that was just impossible at the time because people's heads weren't there yet.

Andrew O'Shaughnessy:

What was the nature of the relief that you were trying to get at that point? Was it just money damages?

Thomas James:

... Under UDAP, under Unfair and Deceptive Trade Practices – this is probably true for almost every office, I think it's true for every office in the FTC – that the driving goal is injunctive. You have to stop the bad acts first. That's goal number one. [It] is to shut it down or to change it so it's not working [towards an] unlawful purpose. So the first thing was to get them shut down, and we managed that. Once they filed for bankruptcy, the number one goal was achieved.

So then you move into restitution, if you can get it, and oftentimes you can't get it because the money's spent, but we were able to get – for the time, it seemed like a huge amount of money, though compared to the loss in my state and others, I thought it was completely inadequate. But I think we managed to get some high sixties, maybe low seventies, \$60 or \$70 million out of the estate.⁵ But had we been able to go after Wall Street, quite possibly [we] would have gotten enough to make

⁵ This settlement was for \$60 million. A Home Lender In a Settlement For \$60 Million, Henriques, Diana B. [New York Times \(1923-Current file\)](#); New York, N.Y. [New York, N.Y.] 22 Mar 2002: A1.

people whole. And probably, who knows, but we may have also shut stuff down and avoided the financial collapse. I remember telling my boss that I wanted to go after Lehman. And she said, “Well, if what you say is true... you might collapse the financial markets.” Well, I don't think so, but actually just the other way around. Had we stopped them, they might not have crashed.

Andrew O’Shaughnessy:

Do you have roughly an order of magnitude, what the dollar value of the damage done in Illinois had been?

Thomas James:

No, I can't. But they were on average taking fifteen to twenty thousand dollars out of every deal, and they had done a lot of business. And of course, the money we got out of them – well, eventually the FTC joined in. So, at that point, once the FTC was on board, there was going to be a national distribution. And so there were places, particularly California, where First Alliance was situated in Orange County, California. And California had been really – [First Alliance] had been very, very active there. So the lion's share of money was going to trying to get restitution to people in California. But it was done on a per capita basis. Depending on how much you lost to them, you got to share of the cake, of \$58 million or whatever it was.

But that was a huge settlement for those days. That really shook people. That AGs had gone and – first of all, we took down a company, a major player in the mortgage market. And second of all, we had covered a lot of ground. So there were certain things that were happening. One was that it had caught our interest. We weren't set up – at least my office wasn't set up, and I don't believe most offices were set up – to be particularly attuned to financial abuses and certainly not in the mortgage realm. And here we were. We were doing some pretty sophisticated litigation, bankruptcy. What it was it – [do] you remember the dancer's name,⁶ but she danced with Fred Astaire. And she said, “I have to do everything he does, [but] I have to do it backwards.”

Andrew O’Shaughnessy:

“And in heels.”

Thomas James:

Yes. So not only have we fought under our statutes and our state courts, but we had also gone into bankruptcy where you have to do everything backwards, backwards in heels in bankruptcy. And we had done that. So we now actually have a litigation team that has had some good chops. So we were a litigation threat in addition to being a regulatory threat. And we were also building capability. People just weren't attuned to

⁶ Ginger Rogers danced with Fred Astaire in ten musical comedy films, including *Shall We Dance* (1937).

these issues. Lawyers are notorious for going to law school to avoid math. And here we are now, slogging it through in the world of high finance.

So it takes time and energy and resources to build a movement and an effective one. We were never as effective as we should have been, but the collapse came and was horrible. And I think we probably could have stopped it if we could have moved faster, but we couldn't move faster. But we did move.... First Alliance was the first to really coalesce a group of AAGs and in a quasi multi-state situation. But that brought us all into contact with one another. So not only did we know that we existed, and we were happy to – and even interesting to be with at times – but we also had the same understanding, which was more advanced than almost anybody else in the marketplace, as far as I can tell.

And we were building on that. And so we started to put together more cases. And the second big case was – actually there was a company based here in Illinois, it was a big finance company that had grown and it kind of paired with one of its rivals and grown into a very large finance company, which was Household-Beneficial.⁷ They were based here, in [the] suburbs of Chicago, and I think they had a book of about, at least... about a half billion, something like that, or more, on any given day.

But they operated very differently than First Alliance. They didn't sell their paper back into the secondary market, which was very unusual. At least, it was a very old business model, and the new [model] was to sell everything, more or less, into the secondary market. And these guys were not doing that. They had big lines of credit that they used to generate loans that they then held on their books. So it was a very different situation. And there was no opportunity to – but I don't think there were people looking at their papers that same way that Lehman was looking at First Alliance.

But Chuck Cross – I think it was Chuck and maybe the New York regulators – had started to identify big problems in the way that Household Beneficial was selling their products to consumers. And the products themselves had pretty predatory features, and there were all kinds of problems with the way they marketed and collected and churned up their customer base.

Andrew O'Shaughnessy:

Could you detail some of those?

⁷ Household International, a consumer lending company, purchased its rival, Beneficial Corporation, in 1998.

Thomas James: I'd sort of have to go back, which I should do, and look at the pleadings, but they were pairing, I believe – one of the problems was, and I'm seeing this resurface now – they had live checks that they would send to people unsolicited. So a check would land in your mailbox for \$2,500. If you cashed it, you were in a high cost loan, or an expensive loan. High cost has a technical meaning under HOEPA. These weren't HOEPA loans, but they were pretty close. They were expensive loans.

Andrew O'Shaughnessy: You say they're not HOEPA loans. By that, [do] you mean they're under the HOEPA triggers?

Thomas James: They were actually not secured. These were unsecured loans. So they weren't even the same category of loans. But they were high cost loans in the sense that – ... they weren't attached to your house or your car, but the object was to get the consumer to cash the loan. And because the interest rate on the loan was so high, [you would] have difficulty paying it off, but they'd also then approach you to refinance the loan. And so they were in the business of up-selling, and once they had an entree into the consumer's financial confidence, they would rewrite them into larger and larger credit. And eventually, refinance the car, and then, if you had one, refinance your house. And these were all very expensive products. We identified what we thought was a tremendous amount of deception in that process in getting people upsold into the most expensive product mix that they had available. So there were ways that they did that. They would give a person a first loan at eighty percent of the home's value. And then a second loan that would effectively put the borrower underwater – that is, they lend the borrower more than a hundred percent of the value of the security.

So they were experimenting with practices that would later on come back to bite the entire nation's financial backside. But the regulators in Washington, Chuck Cross, and in New York – I can't remember the name of the head there – but they had of course, visitorial power. So they could, without any warning, walk in to the headquarters at Household Beneficial and start rifling through the paperwork. And that was not available to us, for instance, with First Alliance or later on with AmeriQuest or later on with Countrywide. But they did have that ability, and they used it. They went in and they found problems, and they found big problems.

And this time, instead of that core of states (Minnesota, Illinois, New York, Massachusetts, Florida, and now California), we had an enormous state AG and regulatory participation. We had probably something like thirty states at the table when we

started negotiating. So there was an army of people now. From a handful to an army. And we worked out a settlement there for almost, probably, I don't remember the – for some reason, \$484 million sticks in my head.⁸ I think that was what the public was shown. There was actually more money than that. That's the amount of money that went back to people. There was also money that was used for other reforms inside the institution, which is probably in the area of \$50 or \$60 million worth of reforms there.

So it was actually over a \$500 million settlement, which was huge. Nobody was talking those numbers outside of tobacco in any state or federal regulatory entity. We were massively – the industry – we had completely caught their attention at that point. [But] that didn't change their – we went from there into big battles with the – the industry fled to the protective veil of preemption under the federal regulators, who were very hostile to us and very protective of the industry in general, and specifically the banks, both the federally chartered banks and the non-chartered subsidiaries and affiliates of the banks. I think the federal regulators just perceived them as being outside of our jurisdiction with respect to all of their financial dealings, which was completely absurd, but that was the position they took. And so they put up a tremendous barrier that... depleted a lot of the energy and resources that we had. So they were effective in slowing us down. They weren't effective in stopping us, but they did effectively slow us down.

And that allowed things, in my opinion, to advance [to] the point of the collapse. We had reached the critical mass where we could have and would have gone on after Wall Street if we didn't have that bulk work [that] we were pushing against. And the entire industry was hostile, of course, but there was really what I would call agency capture. The federal regulators had effectively been captured by the industry, and the industry was using them to deflect us and our quest for justice.

Andrew O'Shaughnessy:

What arguments do you think were persuasive with the federal regulators? How do you think the industry has succeeded in capturing the regulators at the federal level?

Thomas James:

Agency capture has been around as long as agencies. One of the problems is that agencies were literally captured in a financial sense. They were dependent on their charters – first of all, the [banks] could select [state or national charters]; there was

⁸ Household Settles With States Over 'Predatory' Lending, Beckett, Paul and Hallinan, Joseph T. Wall Street Journal, 11 October 2002 at <https://www.wsj.com/articles/SB1034303458192659996>.

arbitrage. The charters could select between chartering a state banking license or one of a number of federal licenses. So they could go to the OCC[Office of the Comptroller of the Currency] or they could go to the Office of Thrift Supervision, which went away with the crash. The agencies were dependent for their existence on licensing and examination fees. They didn't want to bite the hand that fed them. So the regulators were beholden to the licensed entities, which was the wrong way around. And so that was the argument. The argument was, "We'll take a hike if you don't do our bidding." It's a terrible system. One that still exists today, by the way.

Andrew O'Shaughnessy: It hasn't been substantially reformed by the – I guess it hasn't – by [Dodd-Frank and the Consumer Financial Protection Bureau]?

Thomas James: Well, the CFPB is a great leap forward. Unfortunately, in these times it's been muzzled. But yes, the CFPB was funded by essentially the Federal Reserve, as part of the Federal Reserve System. And so its funding is independent of the entities that it regulates, and that's a must for it to be independent. So I'm all for the CFPB. Unfortunately, right now, it's just in a terrible administrative state because of the person who sits in the White House.

Andrew O'Shaughnessy: And the Office of Thrift Supervision and the Office of the Controller of the Currency, are they still funded by charters primarily?

Thomas James: Yeah. So that, that was not undone and there's [an] enormous [amount of] what I would consider a conflict of interest there. Unless something happened that I wasn't aware of.

...I'm sure you'll get to them, but certainly talk to people like Kathleen Keest. There were other people who are out there later who came in, [but] Kathleen Keest was there from the very beginning. Kathleen Keest is a wonderful, insightful intellectual genius. And she had a very deep understanding of the internal workings of the origination platforms that I had not grasped at the time that I crossed paths with her. She was enormously effective in negotiating the Household Beneficial settlement. So that's where you want to do a deep dive on that particular settlement. Kathleen, because she was the center of attention and instrumental in bringing about, I think, some very, very good relief at a time when nobody was thinking in the terms that she was thinking in. So I would certainly encourage you to. She's retired now. I think she went to the... FDIC [Federal Deposit Insurance Corporation] during the Obama administration. And I forget she had been at

NCLC [National Consumer Law Center] before that and the Iowa Attorney General.

Andrew O'Shaughnessy:

... I would love to double click on something you just said in that you thought Kathleen [Keest] was at the forefront of the thinking about the industry's problems in the context of the Household negotiation. Could you tell me what you meant by that, exactly?

Thomas James:

In terms of formulating relief with respect to paying very close attention to the product and also to the underwriting of the product. [Before] Household, First Alliance essentially really aimed at A-paper. They wanted to sell A-paper as subprime. And so they sought people who were perfectly credit-worthy – in fact, more than perfectly, I mean, absolutely great credit – as though they were subprime. So they were able to offer Wall Street a package, which was: prime people were sold subprime loans. So very little risk, huge returns. So the dynamic there was very, very different, and [so was] the remedy. The remedy in First Alliance was to get the cash back to people and get them out of those loans. Those people were basically credit-worthy. They could walk into the market and get a better loan right away. So give them money and get them back into the market with a reputable lender. That was, that was... the correct remedy there.

The remedies in Household were much more complicated because you had a lot of people... who had nowhere to go because they were targeted because they probably weren't eligible for prime credit in the first place. And so you had to work out remedies that would allow them to continue in their loans, but have light at the end of the tunnel.

And so the release that Kathleen helped craft did a lot of that. It was just new territory that the uninitiated, like me, were not prepared [for]. We just weren't... as sophisticated as Kathleen at understanding how that would work. At how you would put remedies in place, institutionalize them in the entity so that you could work people out of bad credit into better credit. And so that was another step in the process of coming to grips with the kind of problems that we were facing and the complicated forms that they presented themselves [in]. Kathleen was instrumental in working through that process. Those negotiations were long and complex.

.... [I]t wasn't long after we settled with them – in fact, it was just after we settled or maybe even the day before – that they were essentially absorbed by Santander Bank. So I think that – I

can't say for sure – but I think that we effectively weakened their ability to resist what might've been a hostile takeover, or to make a consensual takeover much more easily achieved by a bank like Santander that was looking for a subprime market that it could absorb. So there was also a hunger on Wall Street to get into this stuff. And so that's what happened, interestingly enough, in that case. But at that point we now had effectively put together what amounts to a permanently-standing, multi-state enforcement force that was focused on the financial industry. And that didn't exist really until Household. So I think for me, the great achievement there is we coalesced into a multi-state that was focused on this area.

Andrew O'Shaughnessy:

Kathleen [Keest offers] an example of the variation there is in how experienced and sophisticated different staff in different jurisdictions are with these matters. Who would you say were the states that were most sophisticated in their approach at that point?

Thomas James:

Certainly Massachusetts. Massachusetts is on the forefront in this stuff at [a] very capable office, and they've enjoyed great leadership over the years. Minnesota, at least at that time, with Prentiss, was very active. New York for sure. California had come in. Texas, Florida, Washington. I don't know if I'm leaving anyone out, but those are who I, offhand, regard as the core people.

[END OF SESSION]