

# Chapter 1

## Rude Awakenings

**T**he spring of 1987 stands as the bittersweet coda to my protracted adolescence. I was then 35. I had been happily ensconced at Harvard Law School working on an advanced degree of little practical utility other than to serve as an excuse for several years of scholarly lassitude. After getting my first law degree and enduring a year in a vertical lawyer ghetto in Century City, California, I made the discovery that I hated practicing law and could do without most lawyers. So I did what any sensible person would under those circumstances. I went back to school. My vague hope was to become an academic—like my father and grandfather and great-grandfather and God-knows-how-many other pedantic forebears—and never, ever go back to the billable hour treadmill of private legal practice.

The first year in the graduate program was a long slog of coursework, but after that I found I could freely indulge the attention deficit disorder I had previously struggled to repress. Poking around somnolent bookstores in Harvard Square . . . watching the squirrels outside my office window as they scampered across the Yard . . . plugging away on a

doctoral dissertation on an obscure aspect of American economic history . . . and, in the late hours, writing a mystery novel that would eventually be ignored by the reading public. All the while, the school and my employed wife Eileen paid the bills.

This idyll, however, could not survive the news of a pending expansion of our family. While profoundly welcome, the prospect was unsettling. Academic bohemianism is all well and good when you don't have extra mouths to feed. Now responsibility knocked with brutish authority. Eileen seemed less concerned. Coming from a family of eleven, she accepted that children just sort of spring up around couples like mushrooms after a rain-storm. While I fretted daily over what would become of us, she would put on the purple bathing-suit that, as her pregnancy progressed, made her look more and more like an eggplant with feet, waddle cheerfully off to the university pool, and split a lane with an elderly gentleman she thought was John Kenneth Galbraith.

My plan, to the extent that I had one, was to find a not-too-demanding government job while I finished my doctorate and also dealt with the responsibilities of parenthood. I sent out resumes to a raft of federal agencies, not including the SEC. Its application form was onerously long and focused on the applicant's experience with the securities laws, of which I had none. The first to respond was the Federal Trade Commission's Bureau of Consumer Protection. Apparently the bar was not set very high. After a quick interview in Washington, employment was offered and accepted. We loaded our new son and old furniture into a U-Haul truck and migrated from Cambridge to a rented apartment in northern Virginia, across the Potomac from the imperial city.

Every organ of the federal bureaucracy has its own peculiar mores and practices related in some vague anthropological way to its regulatory goals, and which determine whether those goals are to any degree met. The Credit Practices Division of the FTC had a finger into every aspect of the nation's consumer credit industry. With a staff of less than twenty attorneys, it was in charge of so many rules and regulations that some attorneys had a statute or two they were expected to enforce all by themselves from one end of the continent to the other. This was on top of the division's duty to protect the public from every form of credit fraud.

Obviously, this presented the opportunity for chaos. The division was staffed, however, by mild-mannered government lifers, who had no tolerance for chaos. The issue was resolved by drawing constrictive lines around the rules that were enforced, buttressed by onerous procedural hurdles to frustrate any potential deviation from accepted practice, no matter how slight. In this, it was not unique among government agencies.

The FTC's effectiveness was further undermined when then-president Reagan inflicted on it an administration heavy with economists. Economists are like accountants, only more so. They do not count beans so much as argue over whether the beans exist and, if so, which among them deserve to be counted. The FTC economists conducted cost-benefit analyses to determine if Congress had erred in deciding certain practices should be prohibited. Mostly they decided it had. It has been suggested that, during this period, the FTC could see no harm to the American public in any practice not involving actual gunplay.

It might seem this situation offered the opportunity to draw a decent salary without really doing anything. But there is a fine line between not doing anything and not accomplishing anything. In government, the former is sternly frowned upon, but the latter not so much.

My indoctrination to this critical distinction came from a brush with a prominent Texas mortgage company. The experience also provided my initial exposure to the art, well known to large financial entities, of finessing, evading or simply ignoring inconvenient regulations.

In early 1987, the Federal Reserve Board, spooked by rising inflation, cranked up the interbank discount rate a full percent (100 basis points). This gave home mortgage rates a jolt, and lenders were caught between the rock of hundreds of millions of dollars in pending mortgage applications with rates contractually "locked in" and the hard place of a sudden rise in their cost of funds. In short, the loans would be unprofitable. The large Dallas lender Lomas Mortgage elected to shed its lock-in agreements by claiming they applied only when rates went *down*. This made them the equivalent of flood insurance that protects only against losses incurred during a drought. Other mortgage companies performed variations on this theme. Burned applicants eventually figured out that—under our fragmented, incomplete, and incoherent system of financial regulation—the sleepy little Credit Practices Division

of the FTC had jurisdiction over the lending practices of some mortgage companies, Lomas among them.

Together with a younger attorney, who was fresh out of law school, I spent months trying to cajole the company into honoring its lock-in agreements. Lomas fielded a platoon of white-shoe lawyers in its defense. In lead-dog position was Harriett Miers, later nominated unsuccessfully by George W. Bush to the Supreme Court. Counsel was indignant that the government would attempt to tamper with bona fide transactions between corporate lenders and their borrowers, merely because the contracts *happened* to work out in favor of the (well-lawyered) lenders who drafted the contracts and—eschewing persiflage about items of small print—slid them past the (clueless) borrowers.

Lomas wouldn't budge. This meant the FTC either sued or dropped the matter. There followed months of meetings and memos. Much anguish was expressed over proposed legal theories. The FTC, by statute, is empowered to punish "unfair or deceptive" trade practices. But, it was argued, "unfair" could mean almost anything. That being unacceptable, it followed that it must mean nothing at all. And how were these contracts "deceptive" when one could, with careful reading, spot the lurking escape clause? Should people be excused from reading what they sign? Down that road lies perdition. But finally the commission agreed that, even in the era of caveat emptor, the company's conduct was beyond the pale. Shortly before I left the FTC in 1990, we gave Lomas the bad news: settle or be sued. I assumed it would be a matter of weeks before an action was filed.

Three years later, the FTC announced a settled action against Lomas. Nothing in the order indicated there might be anything unfair in drafting contracts so as to render them, in practical application, illusory, as I believed these contracts were. Lomas would pay a total of \$300,000, trickled out to claimants in \$1,000 increments, and agree that henceforth it would make sure its borrowers clearly initialed any weasel language Lomas put in its contracts. The amount paid for redress was likely less than Lomas paid its attorneys for copying and paralegal assistance. Ms. Miers, in her failed confirmation hearing, described the settlement with admirable modesty as "acceptable to Lomas."

In sum, much time and effort was expended to achieve a result of no real value to the public. But I learned from this a useful lesson. After

being mired in this and other cases in which policy concerns trumped common sense, I determined to avoid “issue cases” and look for matters even an economist could love. This meant blatant frauds.

Fortunately, these were not in short supply.

In the days before the Internet, scam artists were largely dependent on the U.S. mail to hook potential marks. Boiler-room operators would send out postcards by the tens of thousands, offering impossibly great deals as part of a purported contest or market survey, and employ squads of telephone salesmen to field the leads that the mailers generated. The object was to extract the caller’s credit card number. At that point, the fish was in the boat. The only question was how many times the person would be billed before he or she realized the charges were for unwanted goods. These operations infested beach communities full of transient young people desperate for employment and disinclined to ask questions.

Typical of these scams was a Venice, California, operation that pumped out mailers promising the recipient “a four-person outboard motor boat” in return for participating in a market survey. The boat, constructed of “pneumatically pressurized compartments,” was described as “suitable for ocean fishing.” Those who called to claim their prize were told yes, the boat was theirs. There was, however, the small matter of a \$300 fee to cover incidental expenses: taxes, the cost to ship the boat “by commercial carrier,” and charges for “transfer of title.”

Tens of thousands of dollars had changed hands before the complaints began to pile up. The phrase “four-person outboard motor boat” had conjured in the minds of many trusting souls something other than an inflatable plastic dingy with an egg-beater motor. And they were pissed. A federal judge in Los Angeles saw their point and, without notice to the company, granted the application of the FTC for an order shutting the operation down and freezing its bank accounts. Judges were usually accommodating in this way—as I discovered after similar experiences in courtrooms across the country—especially once they recognized the defendants’ social stratum (white trash) and the consequent near-certainty that no one would challenge the orders. The company was located a few blocks off Venice Beach. The building, when I found it, looked abandoned: paint peeling from salt breeze and sun, screens torn, litter decomposing in the alcove beside the entrance. But the sign on the door

for American Nautical Adventures looked new and, inside, the place was jumping. Rows of young men in T-shirts and cut-offs slouched in surplus office chairs, each with a telephone cradled between shoulder and ear as he earned his rent.

An inflatable plastic dingy hung from the rafters, shifting in the draft from the open loading dock at the back of the large, uncarpeted room. However innocent in appearance, it was easily identifiable as the source of hundreds of complaints to the FTC.

From a raised dais at one end of the room, a man in his late 20s monitored the activities of the salesmen. His right leg was covered to the knee in a grimy cast and propped on a battered metal desk, an huarache sandal dangling from the exposed foot. His sun-streaked mud-brown hair bulged from under a backwards baseball cap and his T-shirt advertised a bar in Ensenada. The appearance of a suit and tie caused him visible concern. It could only mean trouble. His arms flailed as he righted himself and stood hunched away from his broken leg. He read the order slowly, moving his lips, and winced in dismay when I told him a federal judge had frozen all his assets, personal and corporate, including whatever loose change he had in his pockets.

But a true salesman is never at a loss for words.

A mistake had been made, he tried. Maybe there was another company by the same name. Or one of his competitors was slandering him. It was that kind of business.

Yes, those were his mailers. Sure, that was his boat. But so what? It wasn't like anyone had lied about anything here.

I mentioned a few points where he might have failed to reach a true meeting of the minds with his customers. That was too just much for him to take. Now he was upset. He pointed at the boat dangling overhead and offered to show me it could seat four people or more. If I didn't believe it was good for ocean fishing, there was an ocean just a few blocks away. I could try it for myself. Due to a skateboarding mishap—he knocked on the cast—he couldn't demonstrate the capabilities of the craft himself, but any of his employees would be only too happy.

He had answers for everything. The phrase “pneumatically pressurized” meant you had to blow the thing up. What else? And what he sought to convey by the phrase “the costs of transferring title” was, well, what you paid for the boat. The “commercial carrier” that tossed the

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boat onto your doorstep in its little plastic bag was the very reputable United Parcel Service. And it was also nothing less than the truth that the company was conducting a market survey. That is, it was a survey to determine if people would be more willing to buy a boat if told it was being offered as part of a market survey than if someone just called them up and asked if they wanted to buy an inflatable boat.

I told him he would have every opportunity to make these very compelling arguments to a judge or jury. He did not seem to find this reassuring.

The next day I went by to make sure no sales were taking place and found the office deserted and the local unemployment rolls swelled overnight by the addition of two dozen surfers, dopers and aspiring actors. The phones were gone, but no one had bothered with the furniture.

And the boat was still there, dangling in midair and spinning slowly like a big, clunky mobile.

When sued, these operations usually stole away with whatever was in the till.<sup>1</sup> The challenge was to find and freeze their bank accounts before they got wind of what was coming. That meant figuring out in advance which banks they used. Sometimes it was possible to get this information from the cancelled payment items of their victims, but not always. I tried driving in expanding circles away from the target company office to serve with a freeze order every bank within, say, a mile radius. But this too was hit-or-miss. Once, for a particularly egregious Florida scam, I hired private detectives to search its garbage for financial records.

The detective agency had its office in an old frame house in Daytona Beach. When I walked in to see the evidence it had collected, I found two burly ex-FBI agents jumping up and down, high-fiving each other and yelling as if they'd just won a football pool. They explained their euphoria by pointing to the image flickering on a video monitor. While hiding in a bush, one of the detectives had captured on tape the purportedly crippled victim of an auto accident in a game of beach volleyball, blithely spiking his claim against the insurance company employing the detectives.

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<sup>1</sup>Such was the case with the rubber boat company. It received an injunction against future violations and lost what had been frozen in its bank account. Otherwise, it was in the wind.

They had also achieved solid results in their trash runs for the FTC. Among the pizza cartons and cigarette butts, they found bank statements that revealed where the company stashed its loot. The bulk of the garbage, however, consisted of letters of complaint from people the company had bilked. They were there in the hundreds: crumpled, coffee-stained, and all but a few unopened.