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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Credit Reports on Business Loans

Last year, the Federal Trade Commission ("FTC") issued an interpretive letter dated July 26, 2000, on the application of the Fair Credit Reporting Act to business loan transactions. In its interpretive letter, the FTC addressed the ability of a lender to obtain a credit report on an individual who is a principal of a business loan applicant, or who personally guarantees or cosigns a business loan. The FTC's interpretive letter concluded that a lender would not be able to obtain a credit report in these circumstances without first obtaining the individual's written consent. At the request of federal banking regulatory agencies, the FTC reconsidered its position communicated in its July 26, 2000, interpretive letter, and in a response dated June 22, 2001, the FTC reversed its position. Specifically, in its June 22, 2001, interpretive letter, the FTC concluded that a lender may obtain a credit report on an individual in connection with a business loan where the individual in question is or will be personally liable on the loan such as when the individual cosigns or guarantees the loan, or when the nominal credit applicant is the individual's sole proprietorship, but the individual is liable on the debt. <u>In these circumstances, a lender may obtain a credit report in connection with both the underwriting of the loan and the review or the collection of the account, without the prior written consent of the individual</u>. The interpretive letter of the FTC reversing its earlier position is available on the FTC's web site at *http://www.ftc.gov/os/statutes/fcra/tatelbaum2.htm.*

Seminar Information

Mr. Binns will speak on the topic *How to Recognize a Security* at the Fall Legal Institute of the Arkansas Bar Association on October 26, 2001, at the Fayetteville TownCentre in Fayetteville, Arkansas. The presentation will illustrate practical examples of how anything may be treated as a security (such as the sale of land depending on the marketing techniques) and the prevention of potential problems for failure to comply with state and federal securities laws.

NASD Dispute Resolution

In 1999, the Securities and Exchange Commission approved the creation of NASD Dispute Resolution, Inc. as a subsidiary of the National Association of Securities Dealers, Inc. to handle the dispute resolution program by customers of securities brokerage firms. The subsidiary became operational during the summer of 2000. Through mediation, the program provides an inexpensive alternative to customers of securities brokerage firms before a customer initiates a formal arbitration or court litigation. Mediation is an informal, voluntary approach in which a mediator facilitates negotiations between disputing parties, assisting them to find their own mutual acceptable resolution. Mediation is different from arbitration and court litigation in that the mediator does not provide a decision, but rather helps make it possible for the parties to solve the dispute among themselves. In arbitration, an impartial person or panel hears all the sides of the issues as presented by the parties, studies the evidence, and then decides how the matter should be resolved. Arbitration is final and binding, subject to review by courts only in various limited circumstances. Both mediation and arbitration benefit parties by providing inexpensive alternatives to litigation in the courts. October 2001 has been designated by the NASD as mediation settlement month. During mediation settlement month, prices are reduced to encourage more parties to explore the benefits of mediation. More information concerning mediation and arbitration is available on the web site of the NASD at *http://www.nasdadr.com.*

Excessive Markups on Municipal Securities

Grandon v. Merrill-Lynch & Co., Inc., No. 95-CIV-10742, United States District Court, Southern District of New York, is a recent case which addresses the factors that a court will utilize to determine whether a municipal security markup is excessive and the duty of broker-dealers to disclose excessive markups. A breach of this duty is a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Section 10(b) provides: It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange – (b) to use or deploy, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate in the public interest or for the protection of the investors. This case provides an excellent summary regarding the relevant factors that a court will utilize to determine whether a municipal security markup is excessive. The relevant factors include:

- the fair market value of the security based on the broker-dealer's best judgment at the time of the transaction.
- the expense involved in effecting the transaction.
- a reasonable profit for the broker-dealer.
- the total dollar amount of the transaction.
- the availability of the security in the market.
- the price or yield of the security.
- the nature of the professional's business.

The court found that the purchasers of the securities had adequately alleged facts concerning each of these relevant factors.

Consumer Notice of Adverse Action

The Federal Trade Commission ("FTC") in a response to a consumer's inquiry as to whether a company that had approved an application for credit only under its highest rates, based on a consumer's credit report, would be required to provide the applicant with a notice of adverse action, staff members of the FTC said that the Fair Credit Reporting Act only requires notice under specific circumstances. The consumer would be entitled to an adverse action notice if the consumer applied for credit on particular terms, was offered credit only on less favorable terms, (e.g., lower credit, higher interest rate) based on the information in a credit report and refused to accept those terms or use the credit offered. The advisory letter is available on the FTC's web site at *http://www.ftc.gov/os/ statutes/ fcra/latour.htm.*